S. Hrg. 100-542

REGULATORY FAIRNESS ACT

HEARING

BEFORE THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 1567

TO PROVIDE FOR REFUNDS PURSUANT TO RATE DECREASES UNDER THE FEDERAL POWER ACT

H.R. 2858

TO PROVIDE FOR REFUNDS PURSUANT TO RATE DECREASES UNDER THE FEDERAL POWER ACT

NOVEMBER 18, 1987

Printed for the use of the
Committee on Energy and Natural Resources

U.S. GOVERNMENT PRINTING OFFICE
83-580 WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S311-48

COMMITTEE ON ENERGY AND NATURAL RESOURCES

J. BENNETT JOHNSTON, Louisiana, *Chairman*

DALE BUMPERS, Arkansas
WENDELL H. FORD, Kentucky
HOWARD M. METZENBAUM, Ohio
JOHN MELCHER, Montana
BILL BRADLEY, New Jersey
JEFF BINGAMAN, New Mexico
TIMOTHY E. WIRTH, Colorado
WYCHE FOWLER, JR., Georgia
KENT CONRAD, North Dakota

JAMES A. McCLURE, Idaho
MARK O. HATFIELD, Oregon
LOWELL P. WEICKER, JR., Connecticut
PETE V. DOMENICI, New Mexico
MALCOLM WALLOP, Wyoming
FRANK H. MURKOWSKI, Alaska
DON NICKLES, Oklahoma
CHIC HECHT, Nevada
DANIEL J. EVANS, Washington

DARYL H. OWEN, *Staff Director*
D. MICHAEL HARVEY, *Chief Counsel*
FRANK M. CUSHING, *Staff Director for the Minority*
GARY G. ELLSWORTH, *Chief Counsel for the Minority*

CONTENTS

Page
S. 1567 3
H.R. 2858 6

STATEMENTS

Berlin, Edward, Swindler & Berlin, on behalf of New England Power Co 107
Bruce, Terry L., a U.S. Representative from the State of Illinois 24
Bumpers, Hon. Dale, a U.S. Senator from the State of Arkansas 1
Jackson, Jerry D., senior vice president, Middle South Utilities System 90
Marlette, Cynthia A., legal advisor to the Chairman, Federal Energy Regulatory Commission, accompanied by Jerry R. Milbourn, Deputy Director, Office of Electric Power Regulation 13
Moore, Stephen J., director, Office of Public Counsel, State of Illinois, on behalf of the National Association of State Utility Consumer Advocates 66
Mundy, Rodney O., partner, Balch & Bingham, on behalf of the Edison Electric Institute 74
O'Neil, Robert A., principal in the law firm of Miller, Balis & O'Neil, on behalf of the National Rural Electric Cooperative Association 49
Scully, Maurice, executive director, Connecticut Municipal Electric Energy Cooperative, on behalf of the American Public Power Association, accompanied by Marty Kanner, legislative representative, American Public Power Association 38
Weicker, Hon. Lowell P. Jr., a U.S. Senator from the State of Connecticut 11

APPENDIXES

Appendix I

Responses to additional questions 143

Appendix II

Additional material submitted for the record 268

REGULATORY FAIRNESS ACT

WEDNESDAY, NOVEMBER 18, 1987

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 2:05 p.m., in room SD-366, Dirksen Senate Office Building, Hon. Dale Bumpers, presiding.

STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

Senator BUMPERS. The committee will come to order. Today the committee will hear testimony on the Regulatory Fairness Act of 1987.

I am pleased to be the sponsor of S. 1567, which I introduced in July with several co-sponsors, including Senators Conrad, Weicker, and Metzenbaum of this committee.

Our legislation would amend the Federal Power Act to ensure that purchasers of wholesale electricity and their customers receive timely and effective relief when rates are too high.

When a utility's costs go up, it is entitled to a rate increase to reflect that fact. And when costs go down, as they have been recently, the consumers are entitled to a rate decrease.

The Federal Energy Regulatory Commission is the agency that determines just and reasonable rates for wholesale electricity, and has the responsibility to adjust the rates to respond to changes in the cost of doing business.

Unfortunately, the Federal Power Act does not provide the Commission with the authority to make timely rate adjustments in both directions. That is, rate increases as well as decreases.

If a utility company's costs increase, it may seek a higher rate from FERC. Following a 60-day suspension period, FERC allows the new rate to go into effect from one day to five months later, subject to possible refund at the conclusion of the rate proceeding.

Consumers seeking a rate reduction are not treated as fairly under current law, however. Although it may take several years for FERC to determine that a rate reduction is warranted, relief is not granted until the end of the rate proceeding. And the rate relief is prospective only.

So the consumers receive no recompense for having paid excessive rates during the pendency of the rate proceeding. Moreover, since economic conditions may have changed during the time FERC was considering the case, the utility may immediately file for a rate increase, which goes into effect as described above.

Under this system, consumers have very little incentive to go through the trouble and expense of applying for rate reductions. And wholesale suppliers of electricity have every incentive to delay rate reduction proceedings.

Our legislation would amend section 206 of the Federal Power Act so that the system for bringing utility rates down is similar to the system for bringing rates up. The amendment would direct FERC to set a refund effective date for Section 206 rate decrease complaints.

The refund effective date would be set no earlier than 60 days from the filing of the complaint, but no later than 5 months after the expiration of that 60-day period. If after completing its investigation and proceedings, FERC decides the wholesale rate is too high, the decrease would go into effect retroactively to the refund effective date.

Today there are several factors that indicate that wholesale electric rates may be too high. The corporate tax rate has been reduced, interest rates are down, fuel costs are down, and many utility construction programs have been completed.

There are more than 900 local publicly-owned electrical unit systems, and more than 500 rural electric coops, that purchase all or part of their electric power from investor-owned utilities.

In addition, a number of investor-owned utilities are wholesale customers of generating utilities whose rates fall under FERC's jurisdiction. Yet because section 206 proceedings are so time-consuming and so costly, these wholesale customers have little incentive to pursue rate decreases.

The Regulatory Fairness Act will provide important equitable relief for the millions of consumers served by all utilities that depend on wholesale power purchases to serve their loads.

The legislation is endorsed by the American Public Power Association, the Consumer Federation of America, Environmental Action, the National Rural Electric Cooperative Association, the American Paper Institute, and the National Association of State Utility Consumer Advocates.

In addition, several state public utility commissions, including the Arkansas Public Service Commission, have endorsed the bill.

The two measures pending before us, S. 1567 and H.R. 2858, were introduced as identical companion bills. The House has passed a modified version of its bill. And it is my understanding that the bill would be acceptable to the Edison Electric Institute, as amended by the House.

If the witnesses today have specific comments to make on the House amendments, I am sure the Committee would appreciate hearing them.

At this time I would like to request that a letter from the Arkansas Public Service Commission commenting on the bills before us be placed in the record, following my statement.

[The texts of S. 1567 and H.R. 2858, the letter from Arkansas Public Service Commission, and a statement for the record from Senator Weicker follow:]

II

100TH CONGRESS
1ST SESSION

S. 1567

To provide for refunds pursuant to rate decreases under the Federal Power Act.

IN THE SENATE OF THE UNITED STATES

JULY 30 (legislative day, JUNE 23), 1987

Mr. BUMPERS (for himself, Mr. CHAFEE, Mr. PELL, Mr. CONRAD, Mr. PROXMIRE Mr. WEICKER, and Mr. DODD) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To provide for refunds pursuant to rate decreases under the Federal Power Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Regulatory Fairness Act".

SEC. 2. REFUNDS IN PROCEEDINGS UNDER SECTION 206 OF THE FEDERAL POWER ACT.

(a) REFUND EFFECTIVE DATE.—Section 206 of the Federal Power Act (16 U.S.C. 824e) is amended by designating subsection (b) as (c) and by inserting the following new subsection after subsection (a):

"(b) At the conclusion of any proceeding under this section, the Commission shall order the public utility to make refunds of such amounts as have been paid, for the period subsequent to the refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding. The Commission shall establish the refund effective date. In the case of a hearing instituted on complaint, the refund effective date shall not be earlier than the date sixty days after the filing of such complaint nor later than five months after the expiration of such sixty-day period. In the case of a hearing instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date sixty days after the publication by the Commission of notice of its intention to initiate such hearing nor later than five months after the expiration of such sixty-day period.".

(b) PENDING PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall

not apply to any proceeding under section 206 of the Federal Power Act which commenced before the enactment of this Act.

(2) COMPLAINTS FILED AFTER JULY 1, 1987.—The amendment made by subsection (a) shall apply in the case of a complaint under section 206 of the Federal Power Act brought after July 1, 1987, and on or before the enactment of this Act if the complaint is refiled after the enactment of this Act.

○

II

100TH CONGRESS
1ST SESSION

H. R. 2858

IN THE SENATE OF THE UNITED STATES

OCTOBER 28 (legislative day, OCTOBER 18), 1987

Received; read twice and referred to the Committee on Energy and Natural Resources

---

AN ACT

To provide for refunds pursuant to rate decreases under the Federal Power Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Regulatory Fairness Act".

SEC. 2. REFUNDS IN PROCEEDINGS UNDER SECTION 206 OF THE FEDERAL POWER ACT.

Section 206 of the Federal Power Act (16 U.S.C. 824e) is amended as follows:

(1) At the end of subsection (a) insert:

"Any complaint or motion of the Commission to initiate a proceeding under this section shall state plainly, to the extent practicable, the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. The public utility shall file with the Commission an answer to such motion or complaint and shall specify therein its reasons for disagreement, if any, with the motion or complaint. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated.".

(2) Designate subsection (b) as (c) and insert the following new subsection after subsection (a):

"(b) Whenever the Commission institutes a proceeding under this section, the Commission shall establish a refund effective date. In the case of a proceeding instituted on complaint, the refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date shall not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. In any proceeding under this section, the burden of proof to show that any rate charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section, the Commission shall order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force, unless the Commission determines that such refund would adversely affect the public interest. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding.".

SEC. 3. FEES UNDER SECTION 205.

Section 205 of the Federal Power Act is amended by adding the following new subsection at the end thereof:

"(g) Filing Fees.—The Commission shall not charge any fee in connection with any filing under this section proposing to decrease the amount of any rate or charge made, demanded or received by a public utility.".

Passed the House of Representatives October 27, 1987.

Attest: DONNALD K. ANDERSON,

Clerk.

ARKANSAS
PUBLIC SERVICE COMMISSION
1000 Center
P.O. Box C-400
LITTLE ROCK 72203

Jerrell L. Clark
Director
371-1794

Robert E. Johnston
Chairman
371-1453

Patricia S. Qualls
Commissioner
371-1451

Julius D. Kearney
Commissioner
371-1455

November 2, 1987

The Honorable Dale Bumpers
U.S. Senator
229 Dirksen Building
Washington, D.C. 20510

Dear Senator Bumpers:

As a sponsor of S.1567, you are no doubt aware that on October 13 the House Energy and Commerce Subcommittee on Energy and Power unanimously approved and reported out a substitute version to the companion bill, H.R. 2858, "The Regulatory Fairness Act of 1987." We have just learned that the Senate Energy and Natural Resources Committee will hold hearings on your bill at 2:00 pm on November 18th. Because we have previously-scheduled committments at the annual convention of the National Association of Regulatory Utility Commissioners on that date, we express our regret that none of us will be able to attend these hearings. At the same time, however, we hope you will insert this letter into the record of those hearings as our firm and enthusiastic endorsement of your bill, as well as the House substitute bill.

In the interests of facilitating the passage of this legislation during this term of Congress, we urge you and the Committee to support the House version of this legislation. Both S.1567 and H.R. 2858 as amended would amend Section 206 of the Federal Power Act to allow wholesale customers to obtain refund relief if rates charged by their power supplier are ruled excessive as a result of a FERC proceeding. Under current law, wholesale suppliers seeking a rate increase may collect increased rates subject to refund under Section 205 of the power act. Customers seeking a rate decrease under Section 206, however, are currently not entitled to refund relief.

Rate decreases sought through the complaint procedure authorized under Section 206 of the FPA take effect only at the conclusion of FERC's hearing process and the issuance of a final order and thus are prospective only. In stark contrast, utilities, seeking a rate increase under Section 205 may place rates into effect subject to refund as early as one day and not later than five months after the date they file an application for rate relief.

Evidence presented to the House subcommittee confirmed that in addition to such asymmetry in the language of the statutes governing refunds, there is also a vast disparity in the length of time it takes FERC to rule under the two sections of the FPA. While the Commission customarily will decide a Section 205 rate increase request within 315 days, statistics indicate that FERC takes an average of 647 days to dispose of a customer's request that rates be lowered under Section 206.

Several amendments to H.R. 2858 were adopted by the House subcommittee. We support the substitute bill containing these amendments, particularly since they are of a clarifying nature and will enhance its chances of passage. It is our understanding that the bill as amended will not be opposed by the Edison Electric Institute.

We hope you and your Senate colleagues will vote for and support H.R. 2858 as amended. At the same time, however, we urge that you resist any further amendments that may be proposed. We have been advised that Middle South Utilities may propose an amendment that would prohibit FERC from ordering refunds under Section 206 if such refund would reduce the financial coverage of the company below a level necessary for the conduct of essential public utility business. While on its face such a provision may appear reasonable, we strongly oppose it since it would reverse the presumption now in the bill that refunds shall be ordered. The Middle South approach would shift the burden to 206 complainants (customers) and FERC to prove --- in every case ---that economic hardship would not occur before any refund could be ordered. As you know, it is difficult, if not impossible, to prove such a negative. We believe the language of H.R. 2858 gives FERC ample discretion to consider whether refunds would be "adverse to the public interest."

In conclusion, we commend your sponsorship of this much-needed legislation. Its enactment is in the interest of electric utility ratepayers of Arkansas and the nation; it truly is a step toward regulatory fairness.

Sincerely,

Robert Johnston

Robert E. Johnston
Chairman

Patricia S. Qualls

Patricia S. Qualls
Commissioner

Julius D. Kearney
Commissioner

STATEMENT OF SENATOR LOWELL WEICKER, JR.
ON CONSIDERATION OF S.1567, THE REGULATORY FAIRNESS ACT, SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
NOVEMBER 18, 1987

MR. CHAIRMAN, I WOULD LIKE TO THANK YOU FOR HOLDING THIS HEARING TO CONSIDER S.1567, THE REGULATORY FAIRNESS ACT OF WHICH I AM AN ORIGINAL COSPONSOR. I BELIEVE THE INTENT OF THIS BILL IS VERY CLEAR AND WIDELY SUPPORTED AS DEMONSTRATED BY HOUSE PASSAGE OF THE COMPANION BILL TO S.1567 ON OCTOBER 27.

MR. CHAIRMAN, S.1567 WOULD ALLOW THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) TO ORDER REFUNDS TO ELECTRIC RATEPAYERS THAT HAVE BEEN CHARGED EXCESSIVE OR UNJUST RATES BY UTILITIES. PRESENTLY, FERC HAS NO AUTHORITY TO ORDER SUCH REFUNDS AND THUS RATEPAYERS HAVE FAR LESS INCENTIVE TO UNDERGO THE COSTLY AND LENGTHY PROCESS OF APPLYING FOR RATE REDUCTIONS. EXISTING LAW ALLOWS ELECTRIC UTILITIES TO KEEP REVENUES EVEN THOUGH THEY MAY BE FOUND BY FERC TO BE UNJUST AND UNREASONABLE. IN CONTRAST, THE PROCESS BY WHICH UTILITIES APPLY FOR RATE INCREASES PROVIDES FOR IMMEDIATE IMPOSITION OF HIGHER ELECTRIC RATES WHILE FERC CONSIDERS THE CASE.

S.1567 WOULD AMEND THE FEDERAL POWER ACT TO SERVE THE CONSUMER AND UTILITY ALIKE IN CONSIDERING RATE REDUCTIONS AND INCREASES. FERC WOULD BE REQUIRED TO SET A REFUND EFFECTIVE DATE FOR RATE DECREASES ONCE A COMPLAINT TO THE COMMISSION IS FILED. IF, AT THE CONCLUSION OF AN INVESTIGATION, FERC DECIDES THAT THE WHOLESALE ELECTRIC RATE IS TOO HIGH THEN RATE DECREASES WILL GO INTO EFFECT RETROACTIVE TO THE REFUND EFFECTIVE DATE AND REFUNDS MADE TO THE RATEPAYER. H.R.2858 INCLUDED AMENDMENTS TO THE REGULATORY FAIRNESS ACT DIRECTING THAT REFUNDS SHALL NOT BE GRANTED IF FERC DEEMS THEM CONTRARY TO THE PUBLIC INTEREST. THIS ASSURES THAT UTILITIES WILL NOT BE LEFT FINANCIALLY DEVASTATED BY AN UNREASONABLE RATE CASE DECISION. THE HOUSE PASSED BILL CLEARLY PLACES THE BURDEN OF PROOF ON THE COMPLAINTANTS IN THESE

CASES FURTHER ASSURING THAT WE WILL NOT HAVE FRIVOLOUS COMPLAINTS.

MR. CHAIRMAN, I WOULD LIKE TO WELCOME MR. MAURICE SCULLY, EXECUTIVE DIRECTOR OF THE CONNECTICUT MUNICIPAL ELECTRIC ENERGY COOPERATIVE WHO IS APPEARING BEFORE THE COMMITTEE TODAY IN SUPPORT OF S.1567 AND AS A REPRESENTATIVE OF THE AMERICAN PUBLIC POWER ASSOCIATION. THIS LEGISLATION IS ALSO SUPPORTED BY CONNECTICUT'S DIVISION OF CONSUMER COUNSEL, AND CONNECTICUT'S DEPARTMENT OF PUBLIC UTILITY CONTROL IN ADDITION TO STATE REGULATORY ASSOCIATIONS AND CONSUMER ADVOCATE GROUPS.

MR. CHAIRMAN, IT IS MY HOPE THAT WITH THIS HEARING THE COMMITTEE WILL ACT QUICKLY TO REPORT OUT S.1567. I BELIEVE THAT THIS BILL CREATES AN EQUITABLE AND WIDELY SUPPORTED SYSTEM TO PROTECT AND SERVE CONSUMER AND UTITLITY ALIKE IN THE ESTABLISHMENT OF FAIR AND REASONABLE ELETRIC RATES THROUGHOUT THE NATION.

Senator BUMPERS. I want to say to all the witnesses here that we would be happy for you to summarize your testimony, if you are in a possible position of doing so.

And your full statement will be inserted in the hearing record. And if it is possible to limit your oral statements to five minutes. That would also be very much appreciated.

Congressman Bruce, who is the author of this bill on the House side, had to go vote. He was to be our leadoff witness. He will be back momentarily.

But we will proceed with Cindy Marlette, Legal Advisor to the Chairman of FERC, here in Washington. She is accompanied by Jerry Milbourn, Deputy Director of the Office of Electric Power Regulation.

STATEMENT OF CYNTHIA A. MARLETTE, LEGAL ADVISOR TO THE CHAIRMAN, FEDERAL ENERGY REGULATORY COMMISSION, ACCOMPANIED BY JERRY R. MILBOURN, DEPUTY DIRECTOR, OFFICE OF ELECTRIC POWER REGULATION

Ms. MARLETTE. Mr. Chairman, members of the Committee, I am pleased to appear before you to testify on the Regulatory Fairness Act. With me today is Jerry Milbourn, who is Deputy Director of the FERC's Office of Electric Power Regulation.

We appreciate the opportunity to provide technical comments on the pending legislation. I would like to state at the outset that we are appearing as staff technical witnesses, and our views do not necessarily represent those of the Chairman or any of the other Commission members.

I will try to make my statement brief and summarize it. The Commission provided a memorandum containing comments on the original House version of H.R. 2858. We mentioned two concerns in that memorandum.

One was that the original version would have required the Commission to order refunds from the date that rates are found to be unjust and unreasonable under section 206, whereas section 205 states that the Commission "may" order refunds if rates are found unjust and unreasonable.

The second general concern that we raised was that the original bill was ambiguous as to when the Commission would be required to establish the refund effective date. Both of these concerns were addressed in the version of the bill which was passed by the House on October 27.

I believe that the House-approved bill adequately responds to the concerns that were raised by FERC, but would like to make one observation regarding a provision that was included in the bill which was finally passed, concerning burden of proof.

The House bill states that the burden of proof in a 206 proceeding will be on the complainant. The existing 206 does not refer to burden of proof. Under the existing 206 the burden of proof is controlled by the Administrative Procedure Act, which imposes the burden on the proponent of a rule or order.

This has been interpreted in the case law as the burden of coming forward with a prima facie case. And once that prima facie case is presented, the burden then shifts to the utility to make a persuasive defense.

It is my understanding that the intent of the House bill was to track the APA standard and would not change the historical burden of proof in a section 206 proceeding. In order to avoid any misunderstanding as to that, I think it would be desirable to have it clarified in the conference report.

As a general matter, I believe that the refund provisions of the pending legislation would act as an incentive for parties not to delay 206 proceedings.

Additionally, once the Commission issues an order finding existing rates to be unjust and unreasonable, and ordering new rates to be filed, I think that the utility would have greater incentive to submit a compliance filing which conforms to the Commission's order.

This is important in view of the fact that two courts have recently held that section 206 rates will not become effective until the date of a Commission order accepting a compliance filing which details the rate. As a matter of fact, one of the court opinions was just issued November 4.

Finally, I think as a general matter, the bills appear to provide sufficient discretion to the Commission to work out the practicalities of implementing the legislation. And at this time it appears that the Commission would be able to make its refund effective date decision, based on information which is already on file with the Commission.

In conclusion, Mr. Milbourn and I would be happy to try to answer any questions that you would have.

[The prepared statement of Ms. Marlette follows:]

TESTIMONY OF

CYNTHIA A. MARLETTE
LEGAL ADVISOR

TO
CHAIRMAN MARTHA O. HESSE
FEDERAL ENERGY REGULATORY COMMISSION

ON
S.1567 AND H.R. 2858
"REGULATORY FAIRNESS ACT"

BEFORE THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

NOVEMBER 18, 1987

Mr. Chairman and members of the Committee, I am pleased to appear before you to testify on S.1567 and H.R. 2858, bills to provide for refunds pursuant to rate decreases ordered under the Federal Power Act. My name is Cynthia A. Marlette, and I am Legal Advisor on electric matters to Chairman Martha O. Hesse of the Federal Energy Regulatory Commission. With me today is Jerry R. Milbourn, Deputy Director of the FERC Office of Electric Power Regulation. We appreciate this opportunity to provide technical comments on the pending legislation.

I would like to state at the ouset that Mr. Milbourn and I are appearing as technical staff witnesses. Our views do not necessarily represent those of the Chairman, or any individual members of the Commission.

S.1567 essentially is identical to the version of H.R. 2858 which was introduced in the House of Representatives on July 1, 1987. On October 5, 1987, FERC Chairman Hesse submitted to the House Subcommittee on Energy and Power a memorandum containing general comments on the House bill. That memorandum made two major points. The first was that the plain language of H.R. 2858 would have required the Commission to order refunds from the date rates are found to be unjust and unreasonable under section 206. In contrast, section 205 states that the Commission "may" order refunds if rates are found to be unjust or unreasonable. Under section 205, the Commission normally orders refunds where rates are found to be unjust and unreasonable. However, there could be occasions where refunds would not be appropriate. For example, a utility's financial viability and ability to serve customers could be jeopardized if huge refunds were ordered. The original version of H.R. 2958 would have precluded the Commission from weighing the equities in a particular section 206 case.

The second general concern raised in the memorandum was that the language of H.R. 2858 was ambiguous as to when the Commission would be required to establish the refund effective date, and could be interpreted as requiring that the date be set at the conclusion of a section 206 proceeding. The memorandum stated that if the intent of the legislation is to track the suspension authority granted the Commission in section 205, and to give the utility an up-front indication of the date refunds might attach, this needed to be clarified.

Both of these concerns were addressed in the amended version of H.R. 2858 which was reported from the Energy and Commerce Committee and passed by the House on October 27, 1987. The House-passed bill gives the Commission authority not to order refunds if it determines that such refunds would adversely affect the public interest. The bill was also revised to make it clear that the Commission is to set the refund effective date at the time it institutes a Section 206 proceeding.

A few observations are in order with respect to the House-passed bill now pending before your committee. The House bill states that the burden of proof in a Section 206 proceeding is on the complainant. The existing Section 206 does not refer to burden of proof. Under the existing Section 206, the burden of proof is controlled by Section 556(d) of the Administrative Procedure Act (APA), which imposes the burden on "the proponent of a rule or order." 5 U.S.C. section 556(d) (1977). This has been interpreted as the burden of coming forward with a *prima facie* case, not the ultimate burden of persuasion. *Environmental Defense Fund, Inc. v. EPA*, 548 F.2nd 998, 1012-15 (D.C. Cir. 1976), *cert. denied sub nom. Velsicol Chemical Corp. v. EPA*, 431 U.S. 925 (1977). Once a *prima facie* case is presented, the burden shifts to the utility to make a persuasive defense. *Nantahala Power and Light Company*, 19 FERC 61,152 at 61,276 (1982), *reh'g denied*, 20 FERC 61,430 (1982), *aff'd*, 727 F.2d 1342 (4th Cir. 1984); *Public Service Co. of New Hampshire*, Opinion No. 37, 6 FERC 61,299 at 61,710-11 (1979). Presumably, the language in the amended bill would track the APA standard, and would not change the historical burden of proof in a Section 206 proceeding. In order to avoid any misunderstanding regarding this, it would be desirable to have it clarified in the conference report.

THE AMENDED HOUSE BILL ALSO PROVIDES THAT ANY SECTION 206 MOTION OR COMPLAINT SHALL STATE PLAINLY, TO THE EXTENT PRACTICABLE, THE CHANGE OR CHANGES TO BE MADE IN THE EXISTING RATE, CHARGE, CLASSIFICATION, RULE, REGULATION, PRACTICE, OR CONTRACT THEN IN FORCE, AND THE REASONS FOR ANY PROPOSED CHANGE OR CHANGES THEREIN. THE EXISTING SECTION 206 DOES NOT CONTAIN ANY SIMILAR PROVISION. HOWEVER, THE LANGUAGE ADDED BY THE HOUSE MAY HELP PREVENT FRIVOLOUS CLAIMS FROM BEING FILED AT THE COMMISSION, BY REQUIRING A THRESHOLD OF SPECIFICITY.

AS A GENERAL MATTER, THE REFUND PROVISIONS OF THE PENDING LEGISLATION WOULD ACT AS AN INCENTIVE FOR PARTIES NOT TO DELAY SECTION 206 PROCEEDINGS. ADDITIONALLY, ONCE THE COMMISSION HAS ISSUED AN ORDER FINDING EXISTING RATES TO BE UNJUST AND UNREASONABLE AND ORDERING NEW RATES TO BE FILED, THE UTILITY WOULD HAVE GREATER INCENTIVE TO SUBMIT A COMPLIANCE FILING WHICH CONFORMS TO THE COMMISSION'S ORDER. THIS IS IMPORTANT IN VIEW OF THE FACT THAT TWO COURTS HAVE RECENTLY HELD THAT SECTION 206 RATES WILL NOT BECOME EFFECTIVE UNTIL THE DATE OF A COMMISSION ORDER ACCEPTING A COMPLIANCE FILING WHICH DETAILS THE RATES. ELECTRICAL DISTRICT NO. 1 V. FERC, 774 F.2D 490 (D.C. CIR. 1985); PUBLIC SERVICE COMPANY OF NEW MEXICO V. FERC, ET AL. NO. 82-1148, ET AL. (10TH CIR. NOV. 4, 1987).

FINALLY, S.1567 AND THE AMENDED H.R. 2858 WOULD NOT CHANGE THE EXISTING REQUIREMENT THAT IN A SECTION 206 PROCEEDING THE COMMISSION MUST FIRST FIND THE EXISTING RATE TO BE UNJUST AND UNREASONABLE, AND THEN DETERMINE THE RATE WHICH IS JUST AND REASONABLE. NOR WOULD THEY CHANGE THE CRITERIA USED TO DETERMINE JUSTNESS AND REASONABLENESS. FURTHER, THE BILLS APPEAR TO PROVIDE SUFFICIENT DISCRETION TO THE COMMISSION TO WORK OUT THE PRACTICALITIES OF IMPLEMENTING THE LEGISLATION. AT THIS TIME IT APPEARS THAT THE COMMISSION WOULD BE ABLE TO MAKE ITS REFUND EFFECTIVE DATE DECISION BASED ON INFORMATION ON FILE WITH THE COMMISSION.

IN CONCLUSION, MR. MILBOURN AND I WOULD BE HAPPY TO PROVIDE ANY TECHNICAL ASSISTANCE YOU MAY NEED IN THE COURSE OF YOUR DELIBERATIONS ON THIS LEGISLATION. WE WOULD BE HAPPY TO TRY TO ANSWER ANY OF YOUR QUESTIONS AT THIS TIME.

Senator BUMPERS. Cindy, let me ask you first of all, what is the average length of time it takes to reach a conclusion in a section 205 rate increase?

Ms. MARLETTE. The most recent information we have, from the filing date to the disposition of a complaint, is approximately 647 days.

But I would note that this does not include, oh, I am sorry. You asked about Section 205?

Senator BUMPERS. Yes, I asked for section 205, not 206.

Ms. MARLETTE. Oh, okay, I am sorry. From the filing date to final action, it is 315 days, approximately.

Senator BUMPERS. And the answer then to a 206 proceeding is 647 days?

Ms. MARLETTE. Yes, sir. But that would include not only complaints involving requests for rate decreases, but also other complaint proceedings involving non-rate issues.

Senator BUMPERS. Well, do you have information on just the rate reduction time?

Ms. MARLETTE. I do not believe at this time that we have that breakdown.

Mr. MILBOURN. We can get that information for you, Senator. We do not have it available at the present time.

Senator BUMPERS. We would appreciate that very much. I think those are important figures in this issue.

Is it fair to say that the 206 proceedings, dealing with rate reductions, could you answer this question, normally take considerably more time than the rate increases?

Mr. MILBOURN. Yes, I think that is true, Senator.

Senator BUMPERS. Do you have any opinion, Mr. Milbourn or Ms. Marlette, either one, as to why that is the case?

Ms. MARLETTE. My own opinion is that I believe there is more incentive to delay a section 206 proceeding on the part of the utilities.

I also believe that it may take longer because the complainants do not have the same information that utilities have, and it is often more difficult in the discovery and litigation stage for them.

Senator BUMPERS. There is going to be a suggestion made here by the investor-owned utilities that this amendment could affect the financial health of a utility under some circumstances, if that particular utility was not on very sound financial footing anyway.

And it is my understanding that the House amendments provide FERC with the discretion to deny refund, when a refund would not be in the public interest. Now, could this discretionary authority be used by FERC to take into account the precarious financial health of the utility and to therefore deny a refund?

Ms. MARLETTE. That is my reading of it. That if the utility were in a precarious financial condition such that ordering refunds would jeopardize its ability to render service, then the Commission would have the discretion not to order refunds.

Senator BUMPERS. Does that trouble you any that FERC would have that discretion?

I mean, obviously this does not work in a 205 proceeding, where somebody is asking, they are usually asking for an increase in order to avoid getting into bad financial condition. So, you know, this discretion does not apply there.

But on the other hand, somebody could come in and plead poverty, and you would have the discretion to take that into consideration on whether or not to grant a refund, regardless of the merits of the case.

What if there was a clear-cut case where a rate reduction was in order, but the utility company said this could jeopardize our borrowing ability, and our ability to even stay in business, even though it is obvious that they have either in the past overcharged, or any number of situations might come up?

Would you rather have that in discretionary authority, or do you just think that if the merits of the case warrant it, it ought to be granted? Is it FERC's business to worry about the financial health of these companies? Do you do that in your rate cases?

Ms. MARLETTE. I think when the Commission determines the appropriate rate of return for the utility, it takes into consideration all the factors as to whether the utility will be able to issue securities or whatever it may be.

I think when it comes to refunds, the Commission would normally in almost all situations require refunds. And I obviously cannot predict what a future Commission would do, but I would think that the primary consideration would be the effect on the ratepayers.

The utility would have to be, I believe, in dire financial straits, such that its very ability to render service would be in jeopardy. I think that is what the Commission would look at.

Senator BUMPERS. How many applications for rate increases did you receive in the past 3 years under section 205?

Let me help you with that. Apparently you testified in the House that there were 195. Is that correct?

Mr. MILBOURN. I do not have the figures available. That would be very close to it.

Senator BUMPERS. That was testimony from the House. And the rate, the 206 proceedings in that same period of time, apparently, were 49.

One of my questions is, have you had an increase—if you know—have you had an increase in 206 applications in 1987? I am asking you that because of the fairly significant corporate tax cut that went into effect in 1987. And incidentally, will be even further reduced in 1988.

Mr. MILBOURN. I would say offhand that the number of rate increases filed this year so far has decreased.

Senator BUMPERS. But you could not say that the requests for applications for decreases have increased?

Mr. MILBOURN. The requests for decreases have indeed increased, Senator.

Senator BUMPERS. Why does it take so much longer to get a 206 application acted upon? Are the utility companies just able to prolong it through legal maneuvering and so on?

You have got almost twice the length of time, according to your figures that it takes twice as long to rule on a 206 proceeding, an application, as it does on 205. Is that just because the utilities have the money to hire high-powered lawyers?

Mr. MILBOURN. I think the amount of time that is spent, the 647 days or whatever it is, Senator, is somewhat misleading, because included in that statistic are all other complaints.

I think complaints in general are more complex than straight rate increase filings. And so that number is somewhat distorted.

I would say, however, that under a complaint proceeding under section 206, just the system that is in place, the complaint is filed with the utility, the utility has 30 days to respond to that. Built in to the procedure itself is an extended period of time, in order to give all parties an opportunity to comment.

Senator BUMPERS. Can either of you think of any reason why this bill, these proposed amendments to the 205 proceedings, can you think of any reason why they would be considered inequitable?

Why a rate decrease should not be operative, just under the same terms that a rate increase is?

Mr. MILBOURN. No. I see no reason.

Senator BUMPERS. Does the Commission now have the authority to dismiss a case in any event under either application procedures, if they determine that the application is in fact frivolous or specious? Do you have that authority now?

Ms. MARLETTE. Yes, sir.

Senator BUMPERS. Do you utilize it on occasion?

Ms. MARLETTE. Yes, sir.

Senator BUMPERS. I have a few other questions that I may want to submit to you in writing, Ms. Marlette and Mr. Milbourn.

Thank you both very much for appearing today.

Congressman Bruce, we are pleased to have you here. You are next up.

STATEMENT OF HON. TERRY L. BRUCE, A U.S. REPRESENTATIVE FROM THE STATE OF ILLINOIS

Mr. BRUCE. Thank you, Mr. Chairman, members of the committee. I would like to thank you for giving me the opportunity to testify on S. 1567, the Regulatory Fairness act.

I am not going to dwell on the merits of the act. It was passed unanimously by the House. I think that indicates that we believe the bill should be passed.

And as original sponsor of that legislation in the Senate, I am sure Senator Bumpers is as familiar with the arguments as anyone on the committee. And also you are going to have the benefit of many witnesses to hear from today.

I would like to talk more about the process of how we got from the introduction to the form in which the bill presently finds itself, and the fact that we brought to the Senate a compromise consensus bill, which was approved by the House.

I would like to quote, with the chairman's permission, and enter into the record a letter that was sent by the chairman of the House Subcommittee on Energy and Power, Philip Sharp, and the ranking Republican member of the House Energy and Power Subcommittee, Carlos Moorhead.

The letter basically states that under the Federal Power Act, wholesale suppliers seeking rate increases to cover rising costs recent prompt response.

But wholesale consumers or other parties seeking rate reductions when these costs fall face regulatory impediments and receive incomplete relief. Enactment of the Regulatory Fairness Act will ensure that rate increase and decrease proceedings are handled in the same manner, and afforded the same consideration.

The bill was unanimously approved by the House Energy and Power Subcommittee, and the full Energy and Commerce Committee. It received the broad bipartisan support of 70 co-sponsors from the House.

Extensive discussions have been held with a variety of organizations whose members would be affected by the bill. As a result, a consensus proposal has been agreed to by the following organizations.

The American Public Power Association, the Edison Electric Institute, the National Rural Electric Cooperative Association, the Consumer Federation of America, Environmental Action, the National Association of State Utility Conserver Advocates, and the American Paper Institute.

I suppose, Mr. Chairman, the most important part of this letter is the language, which was cleared by representatives of an investor-owned utilities, and that we achieved a consensus proposal which was agreed to by all the parties represented in the negotiations.

The negotiations, in fact, began before the bill was introduced last July 2nd, when I met with representatives of the EEI, APPA, and representatives of New England Electric, all of whom will testify before this committee today.

After we introduced the bill, we met and had several comprehensive, bipartisan discussions with all the representatives, including FERC and both minority and majority counsel of our committee.

It was our intent to fine-tune a bill so that we could achieve fairness regarding the process of setting wholesale utility rates, without submitting the investor-owned utilities to unreasonable financial risk.

I think the bill which emerged from these discussions accomplished both goals, of being fair to the ratepayer and fair to the investor-owned utility. I think that without going into the large number of refinements and subtitles, I would like to focus on just two major issues, which we resolved in the House.

The first was the concern raised by the representatives of investor-owned utilities that the passage of this bill would lead to the potential filing of frivolous complaints by consumers.

Given the size and the amount of work that FERC already has, the prospect of consumers filing complaints without sufficient data was something that we thought we ought to address.

FERC assured me that there were already sufficient deterrence to the filing of frivolous complaints because it is frankly quite difficult to put together the evidence necessary to file.

And they already have what is known as a top sheet procedure, which allows them to make a quick run-through of the proposal and see whether it has any initial validity.

However, in spite of that, we decided to add to our version of the Regulatory Fairness Act a provision which spelled out exactly what needs to be in a complaint, as well as specifying in the legislation that the burden of proof shall be on the complainant.

In each case, I think this goes the extra step that we needed to assure that the Regulatory Fairness Act does not result in a filing of frivolous complaints.

Secondly, the major concern was that the fear of investor-owned utilities, that they would be financially ruined by large retrospective awards.

In fact it was not the size of the award that concerned them but it was the uncertainty over how much that might be and that would cause them a financial problem as they went into the bond market.

Once again, we found this fear worthy of serious deliberation, and we felt that they were clearly entitled to receive back the cost of their operation and a reasonable return on investment.

But nothing in the Regulatory Fairness Act alters this principle or changes the criteria or the body charge with determining reasonableness.

We believe that this principle must be maintained, not just out of fairness to the investor on utilities, that would be sufficient reason. But it is clearly not in the public interest for us to make it impossible for a wholesale supplier of energy to continue.

Our research indicated that there is already a mechanism that could mitigate against this possibility. To begin with, the rates as approved had a standard of reasonableness. Most utilities can make their own good estimates of the amount of the refund that might be necessary, if anyone filed a complaint.

Indeed, the ability to make good estimates of what is reasonable is the premise upon which our system presently operates. Moreover, FERC stands ready and able to assist any utility that might have trouble in determining what the amount of a refund might be.

Finally, a utility faced with a complaint could always achieve a settlement with the aggrieved wholesale purchaser. We amended the Regulatory Fairness Act by dropping the provision which calls for the effective date of the Act being July 1, 1987.

We think that may increase the uncertainty over the amount of the refunds. And that finally added that no refund would be allowed, Mr. Chairman, that would be in violation of the public interest.

We felt that that was the standard that ought to be had, and we met the complaint and concerns of the investor-owned utilities.

In conclusion, the purpose of the act is to allow consumers to receive a just and reasonable rate reduction in the same way that utilities receive just and reasonable rate increases.

When utility costs go up, utilities deserve a rate adjustment. We do not change that. But when the rates go down, and when the economic factors go in the other direction, consumers deserve just and reasonable rate reductions.

But under the current system, as you indicated in your questioning of the first witness, consumers wait a great deal in time. The average rate increase case takes 61 days. The average rate reduction case takes 676 days.

All this legislation we hope would do would be to remedy that inequity and make sure that both parties are treated fairly.

I would like to just leave my printed statement, and speak with you briefly about a proposal that you are going to hear and some of the testimony that we rejected. We made, I think, major changes.

But one proposal you will hear today is that somehow we put a floor under the amount of the refund that can be requested. I understand Mr. Mundy, representing Edison Electric Institute, and he is not going to ask the Senate to adopt that amendment, but would ask for you to consider it.

We did, and rejected it. My concern was, Mr. Chairman, that if you put a floor, if you are the person filing for a rate reduction, the incentive is to make that floor as low as you can.

Because you know that whenever you file your complaint, get all your data together, if there is a floor below which FERC cannot go, then the best thing for you to do is to file for the biggest possible refund you think you could justify in any complaint.

In other words, it says to the rate complainant, file an unreasonable complaint. We think that was wrong. We felt that the companies were concerned about uncertainty and the size of refunds, and we rejected the concept of floor because that would just say that, FERC, this is the level below which you cannot go in a refund.

But if you are a complainant, you would always, if your complaint sets the floor, then you are going to ask for the largest refund and create the greatest number or amount of uncertainty.

FERC assures me that they can handle the question. All complaints have to be reasonable. And no unreasonable complaint is going to be approved. And we did meet part of that question by putting in that no complaint would be approved if it was going to upset the financial stability of the utility involved.

I just wanted to make that point, we did consider it. And decided that frankly the Act was better off without a floor than with it. With that, Mr. Chairman, I conclude my testimony.

[The prepared statement and letter submitted by Mr. Bruce follow:]

STATEMENT OF CONGRESSMAN TERRY BRUCE
HEARING ON THE REGULATORY FAIRNESS ACT
SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES
NOVEMBER 18, 1987

MR. BUMPERS, MEMBERS OF THE COMMITTEE, I WOULD FIRST LIKE TO THANK YOU FOR GIVING ME THE OPPORTUNITY TO TESTIFY BEFORE YOU TODAY ON S.1567, THE REGULATORY FAIRNESS ACT.

IT IS NOT MY INTENTION TO PRESUME TO DWELL ON THE MERITS OF THIS LEGISLATION. THE UNANIMOUS APPROVAL OF THE HOUSE VERSION OF THIS BILL INDICATES THAT WE IN THE HOUSE OF REPRESENTATIVES BELIEVE THAT THIS A BILL SHOULD BE PASSED AND AS THE ORIGINAL SPONSOR OF THIS BILL IN THE SENATE, SENATOR BUMPERS IS AS FAMILIAR WITH THESE ARGUMENTS AS ANYONE. IN ADDITION, I'M SURE THE MANY WITNESSES YOU WILL HEAR FROM TODAY WILL FURTHER ENLIGHTEN YOU AS TO WHY WE BELIEVE THAT TIMELY PASSAGE OF THE BILL IS NECESSARY.

MY INTENTION TODAY IS TO TALK MORE ABOUT THE PROCESS WHICH WE FOLLOWED IN THE HOUSE AND EXPLAIN WHY WE CHOOSE TO AMEND THE ORIGINAL BILL WHICH I INTRODUCED AND HOW THE COMPROMISE, CONSENSUS BILL WHICH WAS APPROVED BY THE HOUSE CAME ABOUT.

I WOULD LIKE TO BEGIN, WITH THE CHAIR'S PERMISSION, BY QUOTING FROM, AND ENTERING IN THE RECORD, A DEAR COLLEAGUE LETTER WHICH IS SIGNED BY MYSELF, THE CHAIRMAN OF THE HOUSE SUBCOMMITTEE ON ENERGY AND POWER, PHIL SHARP, AND THE RANKING MEMBER OF THE HOUSE ENERGY AND POWER SUBCOMMITTEE CARLOS MOORHEAD.

THE LETTER STATES "UNDER THE FEDERAL POWER ACT, WHOLESALE SUPPLIERS SEEKING RATE INCREASES TO COVER RISING COSTS RECEIVE PROMPT RESPONSE, BUT WHOLESALE CONSUMERS OR OTHER PARTIES SEEKING RATE REDUCTIONS WHEN THESE COSTS FALL, FACE REGULATORY IMPEDIMENTS AND RECEIVE INCOMPLETE RELIEF. ENACTMENT OF THE REGULATORY FAIRNESS ACT WILL ENSURE THAT RATE INCREASE AND DECREASE PROCEEDINGS ARE HANDLED IN THE SAME MANNER AND AFFORDED THE SAME CONSIDERATIONS.

"THE BILL WAS UNANIMOUSLY APPROVED BY THE HOUSE ENERGY AND POWER SUBCOMMITTEE AND THE FULL ENERGY AND COMMERCE COMMITTEE. IT HAS RECEIVED THE BROAD, BIPARTISAN SUPPORT OF NEARLY 70 COSPONSORS THROUGHOUT THE HOUSE. EXTENSIVE DISCUSSIONS HAVE BEEN HELD WITH A VARIETY OF ORGANIZATIONS WHOSE MEMBERS WOULD BE AFFECTED BY THE BILL. THE RESULT HAS BEEN A CONSENSUS PROPOSAL WHICH HAS BEEN AGREED TO BY THE FOLLOWING ORGANIZATIONS:

* THE AMERICAN PUBLIC POWER ASSOCIATION
* THE EDISON ELECTRIC INSTITUTE
* THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
* THE CONSUMER FEDERATION OF AMERICA
* ENVIRONMENTAL ACTION
* THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES
* THE AMERICAN PAPER INSTITUTE"

MR. CHAIRMAN, THE MOST IMPORTANT PORTION OF THIS LETTER, THE LANGUAGE OF WHICH WAS CLEARED WITH THE REPRESENTATIVES OF THE INVESTOR OWNED UTILITIES IS THAT WE ACHIEVED A "CONSENSUS PROPOSAL WHICH WAS AGREED TO" BY ALL OF THE PARTIES REPRESENTED IN THE NEGOTIATIONS.

THESE NEGOTIATIONS BEGAN IN FACT EVEN BEFORE I INTRODUCED THE HOUSE VERSION OF THE BILL ON JULY SECOND OF THIS YEAR. PRIOR TO DROPPING THE BILL I MET WITH REPRESENTATIVES OF EEI, APPA, AND REPRESENTATIVES OF NEW ENGLAND ELECTRIC, ALL OF WHOM WILL BE TESTIFYING TODAY.

SUBSEQUENT TO INTRODUCING THE BILL WE HELD SEVERAL COMPREHENSIVE, BIPARTISAN DISCUSSIONS WHICH INCLUDED REPRESENTATIVES OF FEDERAL ENERGY REGULATORY COMMISSION, THE RURAL ELECTRIC COOPERATIVE ASSOCIATION, APPA, EEI, AND HOUSE ENERGY COMMITTEE COUNSEL REPRESENTING BOTH THE MAJORITY AND MINORITY.

OUR INTENT WAS TO FINE TUNE THE BILL WHICH HAD BEEN INTRODUCED SO THAT WE COULD ACHIEVE FAIRNESS REGARDING THE PROCESS OF SETTING WHOLESALE UTILITY RATES, WITHOUT SUBMITTING THE INVESTOR OWNED UTILITIES TO UNREASONABLE FINANCIAL RISK. I BELIEVE THAT THE BILL WHICH EMERGED FROM THESE DISCUSSIONS ACCOMPLISHED BOTH OF THOSE GOALS.

AS YOU ALL KNOW THIS SORT OF NEGOTIATION TYPICALLY YIELDS A LARGE NUMBER OF REFINEMENTS AND SUBTITLES IN LANGUAGE. I DON'T THINK IT'S USEFUL TO GO INTO ALL OF THESE AT THIS TIME. I WOULD HOWEVER LIKE TO BRING TO THE COMMITTEE'S ATTENTION TWO MAJOR ISSUES WHICH WE CONSIDERED AND HOW WE DEALT WITH THEM.

THE FIRST MAJOR CONCERN THAT WAS RAISED BY REPRESENTATIVES OF THE INVESTOR OWNED UTILITIES WAS THE POSSIBILITY THAT PASSAGE OF THE REGULATORY FAIRNESS ACT MIGHT LEAD TO THE FILING OF FRIVOLOUS COMPLAINTS BY CONSUMERS.

GIVEN THE SIZE AND AMOUNT OF WORK THAT THE FERC ALREADY HAS TO DEAL WITH, THE PROSPECT OF CONSUMERS FILING COMPLAINTS WITHOUT SUFFICIENT BASIS, IS CERTAINLY SOMETHING WHICH NEEDS TO BE ADDRESSED.

REPRESENTATIVES OF FERC ASSURED US THAT THERE WAS ALREADY SUFFICIENT DETERRENT TO THE FILING OF FRIVOLOUS COMPLAINTS BECAUSE IT IS FRANKLY QUITE DIFFICULT TO PUT TOGETHER THE EVIDENCE NECESSARY TO FILE, AND THE FERC ALREADY HAS A TOP SHEET PROCEDURE WHICH ALLOWS THEM TO

QUICKLY PROCESS THE INITIAL VALIDITY OF COMPLAINTS AND SEE IF THERE IS SUFFICIENT REASON TO CONTINUE.

HOWEVER, WE DECIDED TO ADD TO OUR VERSION OF THE REGULATORY FAIRNESS ACT PROVISIONS WHICH SPELL OUT WHAT NEEDS TO BE INCLUDED IN A REASONABLE COMPLAINT, AS WELL AS SPECIFYING THAT THE BURDEN OF PROOF SHALL BE ON THE COMPLAINTANT IN THESE CASES. I THINK THIS GOES THE EXTRA STEP WE WERE ASKED TO TAKE TO ASSURE THAT THE REGULATORY FAIRNESS ACT DOES NOT RESULT IN THE FILING OF FRIVOLOUS COMPLAINTS.

THE OTHER MAJOR CONCERN WAS THE FEAR THAT INVESTOR OWNED UTILITIES COULD BE FINANCIALLY RUINED BY LARGE RETROSPECTIVE AWARDS. IN FACT, IT IS NOT THE SIZE OF THE AWARD ITSELF THAT COULD BE PROBLEMATIC, BUT THE UNCERTAINTY OVER HOW MUCH THE AWARD MIGHT BE WHICH COULD CAUSE A UTILITY A MAJOR FINANCIAL PROBLEM.

ONCE AGAIN WE FOUND THIS TO BE A FEAR WORTHY OF SERIOUS DELIBERATION AND RESEARCH. UTILITIES ARE REGULATED MONOPOLIES AND AS SUCH THEY ARE CLEARLY ENTITLED TO RECEIVE BACK THEIR COST OF OPERATION AND A REASONABLE RETURN ON THEIR INVESTMENT. NOTHING IN THE REGULATORY FAIRNESS ACT ALTERS THIS PRINCIPLE, OR CHANGES THE CRITERIA OR BODY CHARGED WITH DETERMINING REASONABLENESS. WE BELIEVED THAT THIS PRINCIPLE MUST BE MAINTAINED, NOT JUST OUT OF FAIRNESS TO THE INVESTOR OWNED UTILITIES -- THOUGH THAT WOULD BE SUFFICIENT REASON -- BUT IN ADDITION, IT IS CLEARLY NOT IN THE PUBLIC INTEREST FOR US TO MAKE IT IMPOSSIBLE FOR A WHOLESALE SUPPLIER OF ENERGY TO CONTINUE.

OUR RESEARCH ALSO INDICATED THAT THERE ARE ALREADY MECHANISMS WHICH WOULD MITIGATE AGAINST THIS OCCURRING.

TO BEGIN WITH THERE IS THE STANDARD OF REASONABLENESS. MOST UTILITIES IT SEEMS CAN ALREADY MAKE VERY GOOD ESTIMATES OF THE AMOUNT OF REFUND THAT MIGHT BE NECESSARY IF ONE OF THEIR WHOLESALE CUSTOMERS FILED A COMPLAINT UNDER SECTION 206 OF THE FEDERAL POWER ACT. INDEED, THE ABILITY TO MAKE GOOD ESTIMATES OF WHAT IS A REASONABLE RATE IS THE PREMISE THAT OUR SYSTEM OF ALLOWING UTILITIES TO RECEIVE THEIR RATE INCREASES WITHOUT PRIOR REVIEW IS BASED ON. MOREOVER, THE FERC STANDS READY AND ABLE TO ASSIST A UTILITY THAT MAY HAVE TROUBLE DETERMINING WHAT THE AMOUNT OF THE REFUND SHOULD BE, SO THAT IF A UTILITY COULD NOT MAKE A GOOD ESTIMATE OF HOW MUCH THEY SHOULD RETURN, FERC WILL ASSIST THEM.

FINALLY, A UTILITY FACED WITH A COMPLAINT COULD ALWAYS ACHIEVE A SETTLEMENT WITH THEIR WHOLESALE CONSUMER. THIS WOULD PROVIDE THE CONSUMER WITH THE REFUND AT AN EARLIER DATE THAN WAITING FOR THE FERC TO DECIDE THE CASE, AND COULD PROVIDE THE IOU WITH A GOOD DEGREE OF CERTAINTY AS TO HOW MUCH IS AT RISK.

IN ADDITION TO THESE MECHANISMS, WHICH ARE ALREADY IN PLACE, WE FURTHER AMENDED THE REGULATORY FAIRNESS ACT BY DROPPING THE PROVISION WHICH CALLED FOR THE EFFECTIVE DATE OF THE ACT BEING JULY FIRST 1987. THIS SHOULD INCREASE THE CERTAINTY OF IOU'S OVER THE AMOUNT OF REFUNDS THEY COULD BE SUBJECT TO WHEN THE BILL IS PASSED. WE ALSO ADDED SPECIFIC LANGUAGE WHICH CLEARLY STATES THAT REFUNDS MAY NOT BE MADE IN VIOLATION OF THE PUBLIC INTEREST. SINCE, AS I SAID EARLIER STOPPING A UTILITY FROM CONTINUING TO SUPPLY ENERGY IS HARDLY IN THE PUBLIC INTEREST.

I BELIEVE THAT ADOPTING THIS LANGUAGE, WHICH IS BASED ON THE SIERRA CASE, AND WAS SUGGESTED BY FERC, SHOULD BE SUFFICIENT TO PREVENT THE REGULATORY FAIRNESS ACT FROM CAUSING THE DEMISE OF AN INVESTOR OWNED UTILITY.

IN CONCLUSION MR. CHAIRMAN, THE PURPOSE OF THE REGULATORY FAIRNESS ACT IS TO ALLOW CONSUMERS TO RECEIVE JUST AND REASONABLE RATE REDUCTIONS IN A WAY SIMILAR TO THE METHOD USED WHEN THE UTILITIES RECEIVE JUST AND REASONABLE RATE INCREASES.

WHEN ECONOMIC FACTORS PUSH UTILITY COSTS UP, THE UTILITY DESERVES A RATE ADJUSTMENT. UNDER THE CURRENT SYSTEM, WHICH WE DO NOT CHANGE, THEY RECEIVE THIS JUSTIFIED RATE INCREASE BETWEEN TWO TO SEVEN MONTHS AFTER THEY ARE REQUESTED.

HOWEVER, WHEN THESE SAME ECONOMIC FACTORS GO IN THE OTHER DIRECTION, CONSUMERS DESERVE JUST AND REASONABLE RATE REDUCTIONS. BUT UNDER THE CURRENT SYSTEM CONSUMERS NEED TO WAIT UP TO THREE YEARS TO RECEIVE THESE RATE REDUCTIONS AND EVEN THEN THEY ARE GRANTED ONLY PROSPECTIVELY, NOT RETROSPECTIVELY.

THAT MEANS THAT CONSUMERS RECEIVE NO RELIEF FOR PAYING YEARS OF UTILITY BILLS WHICH HAVE BEEN OBJECTIVELY DETERMINED TO BE UNJUST AND UNREASONABLY HIGH. THE REGULATORY FAIRNESS ACT REMEDIES THIS SITUATION.

WE IN THE HOUSE HAVE WORKED TO ACCOMMODATE ALL OF THE CONCERNS OF THOSE AFFECTED BY THE BILL. WE HAVE MADE, WHAT I CONSIDER TO BE, A GOOD FAITH EFFORT TO PRODUCE A CONSENSUS BILL WHICH WAS AGREED TO BY THOSE REPRESENTING THE INVESTOR OWNED UTILITIES AND THE WHOLESALE CONSUMERS.

IT IS OF COURSE NOT A PERFECT BILL, AND I AM AWARE THAT THERE ARE A

COUPLE OF INDIVIDUAL UTILITIES WHO STILL HAVE SOME QUALMS ABOUT IT. BUT I BELIEVE THAT IT IS A GOOD BILL AND ONE THAT DESERVES TIMELY ACTION.

I WOULD ONCE AGAIN LIKE TO THANK THE CHAIR FOR ALLOWING ME TO COME TO THE SENATE AND EXPRESS MY POINT OF VIEW. I WILL BE INTERESTED TO HEAR THE VIEWS OF THIS COMMITTEE ON THIS BILL, AND I HOPE WE CAN CONTINUE TO WORK TOGETHER ON THESE ISSUES.

THANK YOU.

TERRY L. BRUCE
19TH DISTRICT, ILLINOIS
MAJORITY WHIP AT LARGE

COMMITTEES
ENERGY AND COMMERCE
SCIENCE, SPACE, AND TECHNOLOGY

Congress of the United States
House of Representatives
Washington, DC 20515

October 26, 1987

Dear Colleague,

On Tuesday October 27, we are expecting H. R. 2858, The Regulatory Fairness Act, to come before the full House for a vote. We encourage you to support this important measure.

As many of you already know, the Regulatory Fairness Act will establish needed symmetry in the regulation of wholesale utility rates and provide important consumer protection for ratepayers of utilities that purchase electricity at wholesale.

Under the Federal Power Act, wholesale suppliers seeking rate increases to cover rising costs receive prompt response, but wholesale customers or other parties seeking rate rate reductions when these costs fall face regulatory impediments and receive incomplete relief. Enactment of the Regulatory Fairness Act will ensure that rate increase and decrease proceedings are handled in the same manner and afforded the same considerations.

The bill was unanimously approved by the House Subcommittee on Energy and Power and the full Energy and Commerce Committee. It has received the broad bipartisan support of nearly 70 cosponsors throughout the House. Extensive discussions have been held with a variety of organizations whose members would be affected by this bill. The result has been a consensus proposal which has been agreed to by the following organizations:

* The American Public Power Association
* The National Rural Electric Cooperatives Association
* The Edison Electric Institute
* The Consumer Federation of America
* Environmental Action
* The National Association of State Utility Consumer Advocates
* The American Paper Institute

I hope you will be able to support the Regulatory Fairness Act when it comes to the floor. If you have any questions please contact Larry Clinton of Terry Bruce's staff at 5-5001.

Terry L. Bruce
Terry Bruce

Phil Sharp
Phil Sharp

Carlos J Moorhead
Carlos Moorhead

☐ 419 Cannon Building
Washington, DC 20515
202/225-5001

☐ 102 East University Avenue
Champaign, IL 61820
217/398-0020

☐ 106 North Vermilion Street
Danville, IL 61832
217/446-7445

☐ 114 West Chestnut
Olney, IL 62450
618-395-8595

Senator **Bumpers**. Representative Bruce, I understood you were in a hurry and on a tight schedule. I just wanted to ask you one or two questions very quickly.

On the dismissal of these cases, just before you came back, representatives of FERC testified that they now have the authority to determine a complaint or an application to be frivolous or specious.

So why did you put that in the bill?

Mr. Bruce: Well, frankly, it was to satisfy what I consider to be, if you can characterize it, an unreasonable concern.

But it made everyone happier if we put in the fact that on any complaint, it had to be specifically set forth, the reason for the refund. In fact, the burden of proof is on the complainant.

I think that is what the current law is. But we restate current operating procedure. At FERC, it seemed to make everyone more comfortable with the complaint and refund process. And so I included it.

I do not think, Senator, that it makes a great deal of difference, because they are only going to allow reasonable refunds.

Senator **Bumpers**. Well now, burden of proof and frivolous applications are two different things.

You did not change the requirement of the burden of proof as now required under the Administrative Procedures Act.

Mr. Bruce: No.

Senator **Bumpers**. What did you do on the burden of proof then?

Mr. Bruce: We restated the current operation of the Federal Energy Regulatory Commission, as I recall our negotiations.

We basically put into the statutory language the requirements that are under the other complaint, the 205 and 206 now track identically. When you ask for a file for a rate increase, the burden of proof is upon the utility. We made that track the same language saying that when you file a rate reduction the burden of proof is on you to come forward.

Utilities were concerned that, having filed the complaint for a refund, that they would be obligated to bring in data showing that their rate was again just and reasonable. This makes clear that the complainant in a rate reduction case has got the burden of proof to come forward with the evidence that the rate that is currently in effect is not appropriate, fair, and reasonable.

Senator **Bumpers**. I certainly have no problem with that. Senator Ford, do you have any questions of Representative Bruce?

Senator **Ford**. You bother me, Congressman, a little bit when you said that 61 days for a rate increase and I believe you said 657 days for a rate decrease. Is that correct?

Mr. **Bruce**. It was 676. But——

Senator **Ford**. That was 676 days?

Mr. **Bruce**. That is right.

Senator **Ford**. Now, cite me what is in that coverage, other than just rates.

Mr. **Bruce**. I am told by FERC, and I heard their testimony today that that includes all complaints filed.

Senator **Ford**. So that does not necessarily square with your rate decrease.

Mr. **Bruce**. Well, a great deal of those are rate decrease cases. As I understand from FERC in their testimony in the House, it is very difficult for them to peel out, they know exactly when someone asks for a rate increase. Those go under a different docket.

But when they compare all the other complaints filed before FERC, those are aggregated. A great deal of those——

Senator **Ford**. I will ask the investor-owned a little later on what your average was.

What happens to your state pubic service commission? They set the rates and you go through that, and I never had enjoyed doing business with FERC.

Mr. **Bruce**. We are only talking about wholesale purchasers here.

Senator **Ford**. I understand that.

Mr. **Bruce**. State utilities would not be affected, Senator.

Senator **Ford**. Well, I do not enjoy dealing with FERC and leaning on their record. And here you come in and say how great they are and they are going to be fair and everything is going to come up roses.

I have some disagreement with you as it relates to that, and we will have to get you that a little later on. I think you have a problem here in interfering into a business.

We are saying get off our back and out of our pocket, and we are going to do that. And yet I find this Congress and this administration trying to get more regulations on the backs and more taxes in the pocket.

Somehow or another this puts utilities, in my opinion, at some disadvantage and they may have to file a qualified financial statement under the circumstances. That is not basically going to help them with their bonding or ability to build.

Mr. **Bruce**. The only thing Senator I would respond is that what happened when we changed the tax code in 1986, and reduced significantly the corporate tax rate, almost no public utility came forward to ask for a rate reduction.

It was only FERC in the Yankee case, where they moved on their own for rate reduction, that we have finally gotten six public utilities, investor-owned utilities to reduce their rates after they were brought by FERC on their own motion. We thought it would be more appropriate.

Senator **Ford**. Every utility in the State of Kentucky reduced their rates, investor-owned reduced their rates after the tax bill.

We had no problem. They moved forward. No complaints. They reduced their rates. They did what I feel is proper. Now, I cannot say what the other 49 States did. But my State, every investor-owned utility in the State reduced their rates.

Mr. **Bruce**. I wish I had an extension cord that reached down into Kentucky from southern Illinois.

Senator **Ford**. Well, you are just right across the river. Come on down. [Laughter.]

Mr. **Bruce**. You will see me coming over, plugging in my lights at your outside outlet. [Laughter.]

Senator **Ford**. I do not have the kind of problem that you are painting with a broad brush. You know, if my State is doing all right, why bother them?

Mr. **Bruce**. This legislation would not, Senator.

Senator FORD. Well, you are, you are putting a cloud over them or a collar around their neck, and a leash on them. There is something about that I do not like.

I think if we are going to deregulate for an open market sort of thing, and we start setting rates and telling them what we are going to do if there is a complaint, there is always a procedure to get to them without us monkeying in their business.

Even though you all were unanimous in the House, you know there are a lot of unanimous things that have gone through over here that I wished had not.

Mr. BRUCE. I served for 14 years in the Illinois State Senate, and I was always leery of any bill that passed unanimously out of the House.

Senator FORD. Well, when I served in the Kentucky State Senate, we always had a little bill, this one will not hurt you or help you. [Laughter.]

Senator BUMPERS. The next time you look up, the dome is gone off the capital. [Laughter.]

Senator BUMPERS. Congressman, thank you very much for your testimony here.

Our panel consists of Mr. Maurice Scully, American Public Power Association, and accompanied by Mr. Marty Kanner, Robert O'Neil, representing the National Rural Electric Cooperative Association, Stephen Moore, representing the National Association of State Utility Consumer Advocates, Rodney Mundy, representing the Edison Electric Institute, Jerry Jackson, senior vice president, Middle South Utilities, and Edward Berlin, representing the New England Electric System.

Mr. Scully, I am going to take everybody according to the way they are on my list. That makes you numero uno.

STATEMENT OF MAURICE SCULLY, EXECUTIVE DIRECTOR, CONNECTICUT MUNICIPAL ELECTRIC ENERGY COOPERATIVE, ON BEHALF OF THE AMERICAN PUBLIC POWER ASSOCIATION, ACCOMPANIED BY MARTY KANNER, LEGISLATIVE REPRESENTATIVE, AMERICAN PUBLIC POWER ASSOCIATION

Mr. SCULLY. Thank you, Mr. Chairman. I appreciate the opportunity to appear before you in support of S. 1567, the Regulatory Fairness Act of 1987. I am testifying today on behalf of all of the Connecticut Municipal Utilities and the American Power Association.

The Regulatory Fairness Act, it is a simple bill. It will correct an inequity in the current law which is currently, unfairly costing electric consumers millions of dollars.

Before I outline the reasons why this bill is vital to consumers, I would like to note that the Regulatory Fairness Act is directed at only one limited provision of the Federal Power Act.

We are not trying to affect any other part of the Act, other than section 206. We have no desire to burden this limited proceeding with other matters.

We all know that electricity is no longer a luxury. It is a key element in a good quality of life. It is vital, therefore, that regulation of electric utility monopolies should give both consumers and utilities, both the buyers and the sellers, a fair deal.

Utilities should receive and consumers should pay a just and reasonable rate for electricity. No more, no less. Unfortunately, the process does not work that way. The Regulatory Fairness Act of 1987 calls for a simple amendment to the Federal Power Act.

The amendment gives FERC real power to protect the ultimate electric consumers. It returns balance and fairness to the regulatory process. As things now stand, rates are allowed to respond quickly to cost increases, but not to cost decreases.

The lack of symmetry between rate increases and rate decreases proceedings skews the regulatory process. It can and it does result in chronic wholesale overcharges.

The picture is clear. Not only is a level playing field missing, it is positively tilted against consumers. There is no defense for the present system. It denies consumers the basic ability to protect their interests.

The changes proposed in H.R. 2858 and S. 1567 do not alter the FERC's rate-setting standards. Nor do they lift the burden of proof from the parties who challenge an existing rate and seek to replace it with a lower rate.

Rather, the changes simply ensure that rate increase and rate decrease proceedings are handled in the same manner with equitable and equal consideration.

We will never be able to recover the millions of dollars that were not available to consumers because this bill was not in law during the mid-1980s. But we can bring equity to the process from here on in.

The Regulatory Fairness Act, it is a simple and a strong bill. I thank you, Mr. Chairman, and Senators Weicker, Conrad, and Metzenbaum, for co-sponsoring the bill, and bringing the vital consumer protection legislation before this Committee.

We appreciate the work that the staff has done in seeking constructive contributions from APPA and other consumer groups, from the utilities, and from FERC. I respectfully request that this Committee take a very careful look at the House-passed legislation and the effective compromise which it represents. And endorse that compromise.

That concludes my testimony. Thank you.

[The prepared statement of Mr. Scully follows:]

Connecticut Municipal Electric Energy Cooperative
268 Thomas Road Groton, Connecticut 06340
(203) 446-0620
(203) 446-0624

Statement

of

Maurice Scully, Executive Director

CONNECTICUT MUNICIPAL ELECTRIC ENERGY COOPERATIVE

before the

Senate Committee on Energy and Natural Resources

on

S.1567, H.R. 2858 "Regulatory Fairness Act of 1987"

November 18, 1987

Mr. Chairman, my name is Maurice Scully. I am the Executive Director of the Connecticut Municipal Electric Energy Cooperative (CMEEC), a joint action agency that serves the bulk power needs of public power systems in Connecticut. I am testifying today on behalf of CMEEC and the American Public Power Association in support of the Regulatory Fairness Act.

APPA is the national service organization representing more than 1,750 community owned power systems throughout the country. Over 900 of these public power systems purchase all or part of their electric power requirements from investor owned utilities, whose rates are regulated by the Federal Energy Regulatory Commission (FERC). In 1985, five percent of all energy sales from investor owned utilities -- over 102 billion kilowatthours -- was sold at wholesale to public power systems and rural electric cooperatives. The value of these sales was more than $6.5 billion.

I commend Senators Bumpers and Weicker, and the other cosponsors of this legislation, for introducing S. 1567 to correct an inequity in current law that has unfairly cost electric consumers millions of dollars. Upon introduction, S. 1567 and H.R. 2858 were identical bills. As you know, H.R. 2858 was amended in the House Energy and Commerce Committee. The changes made, which I will discuss below, represent a well crafted compromise reached during negotiations between representatives of all three segments of the electric utility industry as well as staff of the House Committee and the Federal Energy Regulatory Commission. I hope the members of this Committee will take a careful look at the House passed version of this legislation and endorse the compromise it represents.

Mr. Chairman, before I discuss the merits and details of this legislation, I would like to note that this legislation is directed at only one provision of the Federal Power Act. I would like to assure you that we will not seek to burden this limited legislation with other issues, and I would hope that others would similarly defer action on other amendments to the Federal Power Act. This Committee's ability to repeal the Fuel Use Act without opening the floodgates for other changes to the Natural Gas Act should assure the Committee that this limited change to the Federal Power Act can be similarly accomplished.

The Regulatory Fairness Act would establish, at long last, important symmetry in the regulation of wholesale electric rates by the FERC. This legislation provides buyers of wholesale power, and their consumers, the mechanism necessary to seek timely, fair relief from utility overcharges.

CMEEC has been involved in four recent wholesale rate proceedings before the FERC. I have become intimately aware of the shortcomings of the current regulatory process. After this experience, it is evident to me that the simple safeguards of symmetry and fair relief are missing.

In principle and in action, the regulation of natural utility monopolies should provide both consumers and utilities with fair and equitable treatment. The basic concept of this regulatory process is to allow utilities to recover their costs and to collect a reasonable rate of return. Utilities should receive, and consumers should pay, a just and reasonable rate -- no more and no less. Unfortunately, the process doesn't work that way.

Under the Federal Power Act, the FERC can act quickly to cover the costs incurred by suppliers of wholesale electric and transmission service when such costs are rising. But the FERC is severely limited in its ability to protect consumers from excessive rates when a supplier's costs drop. Today, when wholesale suppliers ask for a rate increase, they get to take the elevator. When wholesale customers seek rate decreases, they are forced to take the back stairs.

The reasons are these. Section 205 of the Federal Power Act allows utilities to begin collecting proposed rate increases almost immediately. A requested rate increase is put into effect by the FERC after a short suspension period lasting no longer than five months. If, at the end of the FERC proceeding, it is determined that the full amount of the increased rate is not just and reasonable, FERC orders a refund with interest.

Section 205 further directs FERC to give these rate increase proceedings priority over other issues pending before the Commission. These cases are to be resolved "as speedily as possible." (Section 205[e]). According to the FERC, it takes an average of 315 days for these cases to be disposed.

Rate decreases are another story. Under Section 206 of the Federal Power Act, a wholesale customer can petition the FERC to review whether wholesale rates are just and reasonable. But the consumer receives no relief until the slow-moving regulatory process is over. FERC is not required to rule on these cases expeditiously. There are no time limits on either how long the initial review period will take or how long, once established, the formal proceeding will extend. According to the FERC, the average length of time for such proceedings -- including the majority of cases in which a settlement is reached -- is 647 days. That's twice as long as the rate increase proceedings. And even then, any relief is prospective only.

While this regulatory process goes on and on, the consumer pays and pays. No rate decrease can take effect until the final FERC order is issued and the Commission receives and accepts the final compliance report. The relief that is granted is prospective only. This means that, if the FERC determines that a wholesale supplier's rates are excessive, a customer cannot recoup the overcharges paid during the pendency of the proceeding. **The Commission has no authority under Section 206 to refund these overcollections.**

In short, the current process allows rates to promptly respond to cost increases, but not to cost decreases. This asymmetry between rate increase and rate decrease proceedings skews the regulatory process and can result in chronic wholesale rate overcharges.

Many of the production cost components of wholesale electric generation have declined in the last five years. Yet, wholesale electric rates have either not fallen or not fallen proportionately. For example, we all know that the cost of capital has declined dramatically in the past few years. The interest rate on 30-year Treasury bills has fallen seven percentage points: from a high of 14 1/2 percent in mid-1984 down to 7 1/2 percent in the first part of 1987. The consumer should share in the benefit of this cost saving. Yet, during this same timeframe, wholesale suppliers filed 195 applications for rate increases and only 37 applications for rate decreases.

Companies realize that there is only limited likelihood that its wholesale rates will be called into question; hence, there is little incentive to voluntarily adjust rates downward to reflect declining costs of production. FERC acknowledged this fact in response to a question posed by the House Subcommittee on Energy and Power, stating that "the reason why there are not more applications for rate reductions is that there is little incentive for [supplying] utilities to file rate reductions."

Since supply companies are unlikely to file rate reductions voluntarily, and the FERC itself has only limited resources and authority to reduce rates, wholesale customers must take positive action to prevent overcharges. But the current system poses economic disincentives. It discourages a customer from challenging what it believes to be excessive rates. The customer must weigh the possibility of future rate reductions against the certainty of immediate and substantial administrative and legal costs of petitioning for rate relief. The costs of litigating a Section 206 complaint are sobering.

Further, the wholesale customer faces the possibility of winning the battle, but losing the war. Since the only rate reduction that can be granted under a Section 206 proceeding is prospective relief following a lengthy proceeding, it is possible that economic conditions could sufficienty change by the end of the proceedings to justify a new rate increase request by the supplier -- a request which again receives quick treatement at FERC. In this situation, a customer could have incurred two years worth of expenses to recover as little as one day's worth of rate relief.

It is clear that if a wholesale customer chooses to fully litigate a

Section 206 complaint, the best that can be hoped for is partial relief. But the customer has another option: faced with the likelihood of lengthy litigation, a wholesale customer may reach a settlement agreement with its supplier. However, the disadvantage the customer faces in the FERC proceeding remains a disadvantage at the bargaining table. This catch-22 situation is highlighted by the comments of the FERC trial staff in support of a settlement agreement to lower the wholesale electric rates of Wisconsin Public Service Corporation to several of its customers (Docket Nos. ER87-44-001 and EL87-36-000). The staff states that, although the settlement would still result in excessive rates, it is preferable to lengthy litigation since the relief contained in the settlement -- though insufficient -- will be immediate. According to the staff analysis, it would take at least four years for the benefit of the lower rate potentially achievable through further litigation to be greater than the benefits of the rate reduction in the proposed settlement. In other words, the "bird in the hand" axiom forces the customer to accept what is still an excessive rate.

These disincentives discourage wholesale customers from pursuing their own best interests. This is underscored by the fact that in 1986, while the FERC received 42 applications from wholesale suppliers for rate increases, only four Section 206 complaints for rate decreases were filed and set for hearing.

There is no defense for the present system. It effectively denies consumers the opportunity and the ability to protect their interests and their pocketbooks.

This inequity in current law can be easily resolved. S. 1567 and H.R. 2858 establish the symmetry needed in wholesale electric rate regulation. This legislation proposes that a refund effective date be set for Section

206 rate decrease requests. Under the proposal, if the FERC's investigation concludes that rates are excessive, the wholesale supplier would be required to return to its customers the overcharge collected from the refund effective date to the date the FERC issues a final order lowering the rate to a just and reasonable level.

This legislation does not alter FERC's rate setting standards. Rather, the proposed legislation simply ensures that rate increase and decrease proceedings are handled in a similar manner and afforded similar relief.

The FERC has attempted to take limited steps to correct the inequity in current law. The Commission recently held that it may condition the use of cost-of-service formula rates on the supplying utility's agreement to an equity reopener provision. The equity reopener provision would permit a customer, the Commission, or state interests to move annually to reopen the issue of the companies' return on equity component in the formula rates during a specific period. If the rate of return is found not to be just and reasonable, the Commission would have limited refund authority.

As a party to three of the equity reopener proceedings, I commend the Commission in acknowledging the obvious needs of consumers for protection. The FERC has done all that it can within its current statutory authority. But this is only a piece of the pie. On its own, the equity reopner does not fully satisfy the needs of electric consumers. However, it points to a solution. The Regulatory Fairness Act would expand the progress made by the FERC to cover all Section 206 complaints.

Mr. Chairman, as I mentioned, the House passed version of this legislation differs from the bill as introduced. An agreement was reached between the national associations for the three segments of the electric utility industry to incorporate various changes in the House passed version of the bill and support that position throughout the legislative process. I believe the House provision is a fair compromise that adequately protects the interests of all parties. APPA fully supports the changes agreed to in the House and urges its adoption by this Committee without further amendment.

The changes agreed to in the House are:

- **Burden of Proof**: Parties seeking a rate adjustment should shoulder the responsibility of demonstrating the need for the adjustment. The compromise codifies existing practice that the burden of proof in a Section 206 rate decrease proceeding lies with the party seeking the change;
- **Frivolous Filings:** Investor owned utilities were concerned that substantial time and resources could be spent on a meritless complaint. To discourage so-called frivolous filings, the compromise requires the complainant to state, to the extent practicable, the changes being sought and the reason for those changes;
- **Financial Harm:** An important standard of electric utility rate setting is to provide utilities with a rate of return sufficient to continue a vital public service. To avoid situations where a refund obligation would force a utility to go bankrupt or be unable to continue service, the compromise provides FERC an escape clause: if the utility demonstrates that the refund obligation would "adversely affect the public interest," then the FERC can waive the refund requirement;
- **Pending Cases:** While the original bill specifically authorized any party involved in a proceeding pending at the time the bill is enacted to refile for treatment under this legislation, the modi-

fied bill is silent on the issue, leaving it to the FERC to decide how to handle pending cases;

- **Filing Fees:** Under the compromise, no fees will be charged for Section 206 or Section 205 rate decrease proceedings.

Mr. Chairman, this legislation is of vital importance to all electric ratepayers that are served by utilities that purchase power at wholesale -- regardless of the type of ownership of that utility. State consumer advocates and regulatory commissions are increasingly petitioning for, or participating in, Section 206 proceedings. They are aware of the deficiencies in the current Section 206 process, and they see the need for change. I suspect that this awareness will increase as the jurisdiction of state commissions is further eroded by the "spinning off" of generating facilities and new entities are placed under FERC control.

The FERC's periodic review of wholesale electric rates will continue to affect a broad segment of the utility industry, and, ultimately, their retail ratepayers. Reform of this regulatory impediment in current law will give teeth to these FERC reviews, and ensure a fair deal for both utilities and consumers.

I urge this Committee to act expeditiously and approve this legislation. Thank you.

Senator **Bumpers**. Mr. Scully, I have read your full statement, and I want to tell you it is a very, very fine statement. It has some interesting statistics in here that even we in the Committee did not have.

Our next witness is Mr. O'Neil.

STATEMENT OF ROBERT A. O'NEIL, PRINCIPAL IN THE LAW FIRM OF MILLER, BALIS & O'NEIL, ON BEHALF OF THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

Mr. **O'Neil**. Thank you, Mr. Chairman. Mr. Scully has touched on a number of points that were also addressed in the statement that has been submitted to your Committee. And I will not repeat those points.

I do want to note that my appearance here today is not only on behalf of the NRECA, but its member systems. And a number of those member systems I represent in a private capacity as an attorney, with some 14 years of experience before the FERC.

I have had the rather unpleasant opportunity, when faced with a situation where my client felt the rates were excessive, to advise them it really was not worth his while to bring a section 206 complaint to have those rates reduced.

I pointed out the cost of such a proceeding and the fact that the relief could be literally years down the road. And I have been at times faced with the response, well, that is not fair, because they can raise the rates and we have to pay subject to refund.

And I have had to say, you are right, that is not fair, that is the law. And I think the question is whether or not we can bring some measure of fairness to this law, and can we do it in such a way that it is not, if you will, unfair to the regulated utilities?

I know there is some concern about floors and the exposure that a utility must face from a refund. I think a lot of that concern is really unfounded, because there is a floor.

The floor is the just and reasonable rate. The FERC has a statutory responsibility. It is unlawful for the FERC to set a rate other than a just and reasonable rate. And that has been defined to be a rate that does permit the attraction of capital. In other words, it does permit the ability to provide a reasonable return to the investors of the utility.

What we are really talking about is whether we should allow a situation to continue where, if you will, monopoly profits, profits over and above a just and reasonable rate, can be retained, it can be retained for a lengthy period of time to the detriment of consumers.

And again, I have got to emphasize that I am aware of situations where literally businesses have, and this is a consumer now, due to the price of electricity has been forced to curtail and perhaps discontinue certain business operations.

Excessive rates have a very, very adverse impact in consumers. And it is not necessarily just a few dollars. It could be their livelihood.

Again, I would urge this Committee, I would urge the Senate to enact this legislation and try to bring a measure of equity to the Federal Power Act. Thank you, sir.

[The prepared statement of Mr. O'Neil follows:]

TESTIMONY OF

ROBERT A. O'NEIL

ON BEHALF OF THE

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION

BEFORE THE
UNITED STATES SENATE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

ON THE
REGULATORY FAIRNESS ACT OF 1987

November 18, 1987

My name is Robert A. O'Neil, and I am a Principal in the Law Firm of Miller, Balis & O'Neil, P.C. of Washington, D.C. I am appearing today on behalf of the National Rural Electric Cooperative Association (NRECA) and its member systems to offer our support for H.R. 2858, as passed by the United States House of Representatives, and the principles embodied in S. 1567, the Regulatory Fairness Act of 1987 (RFA). I would like to express NRECA's appreciation to you, Mr. Chairman, for holding these hearings, to Senator Bumpers for introducing the legislation, and to the eleven cosponsors of the Act.

NRECA is the national service organization for more than 1,000 rural electric systems which provide central station power to about 25 million people. Approximately 400 of NRECA's members purchase firm power either directly or indirectly from investor-owned utilities (IOUs) whose wholesale rates are regulated by the Federal Energy Regulatory Commission (FERC). These purchases represent approximately 21% of all energy purchased by rural electric cooperatives. The cost of these purchases is roughly two billion dollars per year. Passage of this legislation, which amends the Federal Power Act to limit the time excessive rates may be continue to be collected from wholesale customers, is essential to the fair regulation of wholesale rates, a matter of vital interest to our members.

BACKGROUND

Let me first engage in a little elementary background discussion. As I am sure you are aware, electric service in the U.S. is provided to the public at large, that is retail consumers, by one of three segments of the electric utility industry: investor-owned utilities, municipally or publicly-owned utilities, and cooperatively-owned utilities. A significant amount of the electricity sold to retail consumers first is the subject of a wholesale sale from one electric utility to another. When such sales are made by an investor-owned utility (IOU) to a cooperative or municipal system, the sale is subject to the regulation, or jurisdiction, of the Federal Energy Regulatory Commission (FERC).

The normally expected pricing tensions that exist in any supplier/customer relationship are heightened by the fact that the IOUs and their cooperative and municipal customers long have been recognized as competitors. The nature of the competitive relationship is different from what is typical in most commercial relationships. On the one hand, electric utilities usually, but not always, have geographically defined service areas in which they enjoy a monopoly on the retail distribution of electricity. On the other hand, factors such as limitations on transmission access, often mean that a wholesale customer of an IOU competitor has no viable alternative source of bulk power supply.

The competition is, however, real and it is apparent on several fronts. For example, new electric loads are often very attractive to an electric utility. New retail customers may permit the more efficient utilization of existing facilities, and thereby lower overall costs to all retail consumers. New electric load also can provide tangible economic benefits, in the form of new jobs and an enhanced tax base, to the community at large. When an industry, a commercial entity, or even a residential user, is evaluating new locations, the price of electric service can be a significant and, in certain instances, the determinative factor.

When an investor-owned utility is competing for such new customers against a municipal or cooperative utility to which it provides wholesale service, there exists a very understandable incentive for the IOU to charge the co-op or municipal system the highest possible rates for as long as a time as possible. Such a policy reaps a double reward for the IOU power supplier: it significantly enhances its ability to acquire new load at the expense of the wholesale customer, while at the same time it extracts an excessive profit on its sales to the wholesale customer. While such conditions last, there obviously can be no effective competition for new loads.

Another form of competition affecting cooperative and municipal utilities, and that is influenced by excessive wholesale rates, involves the ability to remain in business at all. The inability to promptly lower excessive rates, or at least assure that excessive collections will be refunded, can impose pricing pressures on wholesale customers that threaten their very existence.

One of the long recognized contributions that public power makes to the electric utility industry at large is a measure of "yardstick" competition. When a regulated utility is able to impose and maintain an excessive wholesale rate on its customer/competitor, it artificially lops a few inches, or perhaps even a few feet, off the yardstick and undermines the public benefit of this form of competition.

It is for the reasons set forth here, by way of background, and for others, such as the "yardstick" theory of competition, that FERC regulation of wholesale electric rates and the changes proposed in that regulation through the RFA are so critical to many of NRECA's members.

THE REGULATORY FAIRNESS ACT

Under the proposed changes incorporated in the RFA, cooperative and municipal systems that purchase power from IOUs, state regulatory commissions, and other entities that are affected by the rates charged by FERC regulated utilities, will be able to seek rate reductions, and have reductions that the FERC finds appropriate implemented in a timely and equitable manner. It would also "levelize the playing field," a phrase currently in vogue, by significantly increasing the ability of wholesale customers to compete with their investor-owned electric suppliers. No longer will extended litigation strategies and administrative delays determine when electric rates will return to just and reasonable levels, when no comparable delays affect the timing of rate increases.

RATE INCREASES UNDER THE FEDERAL POWER ACT

The Federal Power Act currently provides IOUs with the ability to implement rate increases after a two-month "notice," or waiting period. If the FERC staff determines that the filed rate may not be "just and reasonable," the effective date of the rate increase can be delayed from one day to a maximum of five months (the "suspension period"). Once the suspension period has expired, the rate increase can goes into effect, and remains in effect until another rate change filed by the utility becomes effective or the FERC issues a decision.

There is some protection from excessive rates accorded wholesale customers under the Federal Power Act. Any portion of the filed rate ultimately deemed excessive by the FERC can be refunded, with interest, retroactive to the effective date of the filed rate. As noted by the Supreme Court in Tennessee Gas Transmission Company v. FERC, 371 U.S.145 (1962), the refund provisions of the Federal Power Act do not provide a complete bond against injury from excessive wholesale rates. The IOU which supplies power to wholesale customers, and is also a competitor of those customers, may realize long term economic benefits from subjecting its customers to an excessive rate increase, notwithstanding the fact that the excessive rates are ultimately ordered to be refunded. As I mentioned earlier, potential customers may be lost to the supplier/competitor due to the "apparent" cost of electricity as reflected by the rates charged at retail by the wholesale customer. Also, the financial strength of the wholesale customer, and hence his ability to remain a viable competitor, can be significantly undermined if, in addition to the lost potential of new load, there is an erosion of the existing customer base. This erosion can result from customers responding to high electric rates by relocating, switching to alternate sources of fuel, or discontinuing operations entirely. Any of these actions results in lost revenues to the wholesale customer and a weakening of its financial condition.

The ability of the IOU power supplier to increase the cost of power to its customer/competitor, by an amount which has yet to be subjected to the administrative process, provides that power supplier with a significant competitive advantage. This competitive advantage is significant since the wholesale power bill represents about 70% of the wholesale customer's rate to its own consumers. The competitive problem is further exacerbated by the fact that the IOU power supplier has no obligation to seek a similar increase for its own retail customers.

The inequities of this situation, however, are not before us today. The issue today is whether the much more egregious injustice that occurs when an existing rate becomes excessive will be allowed to continue.

RATE DECREASES UNDER THE FEDERAL POWER ACT AND THE NEED FOR REFUND PROTECTION

Section 206 of the FPA is the statutory mechanism whereby rates that are unjust and unreasonable can be set aside, and new, just and reasonable rates established. However, unlike rate increases filed pursuant to Section 205 of the FPA, which become effective in as soon as two months after filing and at most seven months after filing, rate decreases sought pursuant to Section 206 cannot become effective until FERC conducts a hearing, finds the old rate to be excessive and establishes a new, lower rate to be effective prospectively from the date of its order.

Recent reports indicate that these Section 206 rate reduction cases average 647 days, about two years, before the rate is decreased. This compares to the minimum 60 days which many IOUs await before a rate increase becomes effective.

While Section 205 of the FPA offers some protection in the form of after the fact refunds to wholesale customers, the rate reduction provisions of Section 206 offer none.

Rates which ultimately are set aside as excessive remain in effect during the entire pendency of the rate reduction case. The portion of the wholesale rate which is excessive is lost to the IOU's customer forever. The purpose of the RFA is no more than to remedy this inequity. It provides wholesale customers with some protection against excessive rates by requiring a refund obligation for only that portion of the rate deemed excessive, and only for the period subject to FERC review.

RETURNING FAIRNESS TO RATE CHANGES -- THE REGULATORY FAIRNESS ACT

The Regulatory Fairness Act will provide the protection needed by wholesale customers against rates which are excessive. In a manner and time frame virtually identical to that applicable to IOUs in rate increase proceedings, the RFA provides a minimum two month notice period, during which the existing rates would remain unexposed to a refund obligation. The FERC would be empowered with the discretion to delay refund exposure for a maximum of five months. The refund effective date set by the FERC will mark the beginning of the power supplier's refund obligation for that portion of the wholesale rate ultimately deemed excessive.

One way in which Section 205 and Section 206 will remain different is that, unlike the IOU which can unilaterally change a rate, a customer complaint of excessive rates must still await a decision by the FERC before the rates can be lowered. Or, put somewhat differently, customers will continue to be required to pay rates that ultimately are found to be unjust and unreasonable until the FERC can render a decision that orders a rate reduction.

RETURNING FAIRNESS TO SETTLEMENT NEGOTIATIONS

The RFA would also significantly affect the ability of wholesale customers to negotiate a fair settlement of rate reduction cases. At present, the wholesale supplier has all the bargaining power. The longer the case drags out, the longer it will be able to collect and retain excessive profits. The wholesale customers are caught between the need for rate relief and the cost of litigation, and must keep in mind that the IOU can file for a rate increase at any time, completely nullifying the effect of the rate decrease.

Because wholesale customers are generally small electric utilities that can ill afford the legal fees associated with protracted litigation/negotiations, rate reduction cases are frequently settled early, on the IOU's terms.

PROVIDING FERC WITH THE ABILITY TO MAKE NEEDED CHANGES

Lack of a refund obligation also renders FERC incapable of effectively dealing with significant changes which occur once a wholesale rate has been established. One such example is the Tax Reform Act of 1986 (TRA), which reduced the corporate tax rate from 46% to 34%. FERC has no real power to order the reduction of wholesale rates, set at the old 46% rate, to reflect the new 34% rate. In view of the fact that it takes approximately 647 days to process a rate reduction case now, if FERC had to conduct rate reduction proceedings for each of the utilities it regulates to compel recognition of the TRA, it would experience regulatory gridlock. FERC chose the only practical means available to it to reflect the TRA -- it established a rule encouraging IOUs to voluntarily apply for a rate reduction reflecting the TRA by limiting the reduction to only the change in the tax rate. No other part of the wholesale rate would be reviewed or changed, notwithstanding the fact that many wholesale rates reflect equity return levels well above 15%, a figure that is high for today's market conditions. If utilities failed to make the voluntary TRA filing, FERC threatened them with a rate reduction proceeding considering all aspects of the IOU power supplier's rates.

A similar problem exists with respect to FERC's ability to adjust formula rates, which it has approved in the past. Under a formula rate, all cost changes, except for return on equity, are automatically reflected in the rates. FERC has rightly refused to permit automatic changes in return on equity since, as pointed out by the FERC Office of Electric Power Regulation, "this aspect of a utility's rates requires an assessment of market conditions." FERC has indicated its concern that formula rates accepted in past years when financing costs were much greater, are now excessive. Unfortunately, FERC cannot establish refund effective dates for any of the formula rates which it believes are now excessive. It must launch an investigation, hold hearings and make a final determination of a new rate. Of course, there are no refunds for the period during which the rate was in effect and excessive.

THE REGULATORY FAIRNESS ACT WILL HAVE A SIGNIFICANT IMPACT ON COMPETITION

Introduction of the RFA is extremely timely considering the proposals by FERC and certain IOUs to move the industry toward more competitive bulk power markets. NRECA believes that the RFA may be one of the most significant proposals set forth to date to increase competition, and should be considered the first test of FERC and certain IOUs' commitment to more competitive markets.

The RFA will significantly increase competition in a major and extremely important area of the market, the area where cooperative and municipal systems compete with their own wholesale suppliers. This competition is seen in two interrelated ways. First, there is the competition to have new customers choose to locate in a particular utility's service territory. Utilities compete for these new loads, not by promising lower rates in the future, but by having a low rate when the industrial, commercial or residential customer is making its decision.

Second, and considerably more important, is the viability of the wholesale customer/competitor itself. When retail rates of our members are higher than those of the wholesale supplier's, the very existence of the cooperative or municipal customer is at stake. Competition in that market is obviously reduced or removed when the service area the IOU once refused to serve is ultimately sold because it can no longer compete. It is cause for even greater alarm when that sale is to its former IOU competitor/wholesale power supplier, and generally, that would be the case.

SUMMARY

In concluding, let me again commend the Committee for addressing this issue of vital importance to many of our members. The RFA does no more than provide balance to the wholesale ratemaking process, which will help to ensure that competition will be a part of the electric utility industry. I urge the Committee to rectify the injustice that now exists under the Federal Power Act in the disparate treatment accorded rate increases and rate decreases. I also respectfully suggest that H. R. 2858, as passed by the House of Representatives, and which the Edison Electric Institute, the American Public Power Association, and the National Rural Electric Cooperative Association have accepted as reasonably balancing the interests of regulated utilities and consumers alike, be adopted as the vehicle to rectify the inequity that now exists.

Senator BUMPERS. Thank you very much, Mr. O'Neil.

Mr. Moore.

STATEMENT OF STEPHEN J. MOORE, DIRECTOR, OFFICE OF PUBLIC COUNSEL, STATE OF ILLINOIS, ON BEHALF OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

Mr. MOORE. Mr. Chairman, thank you for inviting me here today.

I am appearing on behalf of the National Association of State Utility Consumer Advocates. This is a national organization with 38 state members and also the District of Columbia. Our members represent state ratepayers of public utility companies. So we have a perspective that goes beyond just the rural electric co-ops and also the municipal ratepayers. In fact, we represent also ratepayers of investor-owned public utilities.

I am the Director of the Office of Public Counsel, which is a State agency in Illinois, which is an agency that represents utility ratepayers, and we are a member of NASUCA.

We at NASUCA do support the act as a movement towards symmetry in the Federal Power Act so that there is a way to reduce rates the same as there is a way to increase rates, so that the rules are similar. Our initial concern with the old act was that the asymmetry of the act protected wholesale suppliers during times of rising costs, but it failed to protect wholesale customers and ultimately the retail customers who we are concerned with, in times of falling costs.

The Regulatory Fairness Act of 1987 addresses these concerns and this inequity by making the procedures similar.

At this time, it is very important to have some mechanism that allows rate decreases, and we have with the new Federal Tax Act, and also lower interest rates, there is more of an opportunity for rate decreases. We heard earlier the figures from FERC on how many section 206 complaints there were in the past year compared to section 205. It should not even be close. The section 206 complaints should really be exceeding the 205 rate increases at this time due to the fact that all the conditions out there that affect utility costs are generally moving downward.

I know in the State of Illinois we are seeing very few rate increases, and instead, are looking at rate decreases across the State.

So one of the problems, and one of the reasons for this disparity in the Federal power arena is the concerns you have heard today on how difficult it is to get a rate decrease that is effective because of the fact that you will not see that money until the conclusion of the complaint or the hearing process.

Now, we at NASUCA have been processing and working on rate decreases across the country, and we have seen how other state commissions can take advantage of their procedures. In addition to being able to obtain refunds, just the fact that things are out there like that, or even provisions that allow commissions to immediately reduce rates, these can act as a club that can get the utility companies to come in and negotiate fairly and get decreases without having to go through the massive administrative procedures.

So it does more than simply make it easier to litigate. It also makes it easier to settle cases and get decreases on the boards and effective immediately. So that has been effective across the country, and what we would like to see is something that makes the FERC procedures have some teeth in them that will give FERC people and also customers of utilities that file complaints the ability to really sit down in an equal bargaining position and try and get those decreases.

Finally, I would like to point out that the beneficiaries of this Act are more than just the rural electrical co-ops and also the municipal customers. We have seen across the country a movement of investor-owned utilities setting up corporate structures that allow them to put much of their power production under FERC jurisdiction. In New Mexico there is currently a proposal in which the public service company in New Mexico is trying to set up a mechanism that will allow it to put all of its generating capacity into a subsidiary that would sell to the regular distribution company. That power will be under FERC jurisdiction, and customers of the distribution company, in order to really get those rates down, will need to go to FERC, and we want to see procedures in place that allow those customers to do that.

In Illinois we saw a proposal by Commonwealth Edison Company that would have put three nuclear plants into a subsidiary. Again, because of the law, the Naragansett doctrine which requires State commissions to follow the FERC-approved rates, our State commission would be stuck with the rates that FERC has approved, and in order for us to complain about the rates that Edison would have been charging from those three plants, we would have had to go to FERC. But under the current law, we could not have gotten a decrease.

So again, this is something we are seeing a movement toward across the country. I should add that was also rejected by our commission, so it actually has not occurred. But it is a movement. There are many utilities out there that are looking at this kind of an idea of moving away from state regulation and what we call escape to FERC. And one of the reasons is the difference in regulation. It is perceived that FERC is a little bit more lenient, the procedures will allow——

Senator BUMPERS. A little bit more lenient?

Mr. MOORE. It depends upon the State. I mean, I would say there are probably some states that my fellow advocates would believe rank down there or up there with FERC. So I am sure it depends on who you are talking to.

So in conclusion, we do support the Act as it has been amended. We understand this is a consensus bill. We would urge that it be made no easier on the utility companies. This has had the amendments that we think are satisfactory, but really, we do not think much more would be acceptable.

Thank you.

[The prepared statement of Mr. Moore follows:]

Testimony of
Public Counsel Stephen J. Moore

On Behalf of

National Association of State Utility Consumer Advocates
and
Office of Public Counsel of the State of Illinois

Before the United States Senate
Committee on Energy and Natural Resources

S. 1567

The Regulatory Fairness Act of 1987

National Association of State
Utility Consumer Advocates
1424 16th St. Suite 105
Washington, D.C. 20036
(202) 328-8600

Office of Public Counsel
516 East Monroe St. Suite 701
Springfield, Illinois 62701
(217) 785-7687

November 18, 1987

I am here today on behalf of both the National Association of State Utility Consumer Advocates (NASUCA) and the Office of Public Counsel of the State of Illinois, to support S. 1567, the Regulatory Fairness Act of 1987 as approved by the U.S. House of Representatives.

NASUCA is a national organization composed of 44 members in 38 states and the District of Columbia. Each member is designated by its state to represent public utility ratepayers before state public utility commissions, federal agencies and state and federal courts. NASUCA assists in the exchange of information between its member organizations and provides information on public utility policy issues to the United States Congress and federal regulatory bodies.

The Office of Public Counsel of the State of Illinois is one of the members of NASUCA. It is a state agency authorized by statute to represent the people of the State of Illinois before all state and federal bodies that affect public utility policy and regulation. I am the director of that agency.

On September 11, 1987, NASUCA passed a resolution supporting the Regulatory Fairness Act of 1987. The basis for this support is the need for symmetry in the regulation of wholesale electric rates. Section 205 of the Federal Power Act allows FERC jurisdictional utilities to collect increased wholesale electric rates after a suspension period lasting no longer than five months, subject to refund after completion of FERC proceedings. Conversely, no such immediate action is allowed when the subject is a rate decrease. Section 206 of the Act, which governs rate adjustment requests initiated by wholesale customers, state utility regulatory commissions, other affected parties, or FERC itself, provides only prospective relief after completion of the FERC proceedings. Because these proceedings may last as long as two years, the current law requires wholesale customers to pay excessive rates for a considerable period of time.

This asymmetry in the Act thus protects wholesale suppliers during periods of rising costs, but fails to protect wholesale customers and the ultimate retail customers during periods of falling costs. The Regulatory Fairness Act of 1987 addresses this inequity by providing the wholesale customers the same protection available to wholesale sellers.

Falling interest rates and the reduction in the federal corporate tax rate by the Tax Reform Act of 1986 have highlighted the need to correct the Federal Power Act. Many customers of FERC regulated utilities are paying rates based on costs of capital determined during periods of high inflation and on the old 46% statutory tax rate. In order to receive the benefits of their sellers' reduced costs, however, these customers will have to wait until the completion of their Section 206 complaints or the completion of the investigation initiated by FERC in its

Notice of Proposed Rulemaking in Docket No. RM87-4-00. This latter investigation may also run up against the limitations of Section 206, because FERC may need to bring individual show cause actions pursuant to that section if utilities do not voluntarily reduce their rates pursuant to the proposed rulemaking. Because of the length of time they can draw out those proceedings while continuing to collect excessive rates, wholesale sellers have no incentive to reduce rates voluntarily.

To understand the procedural unfairness of the Federal Power Act, imagine what will happen if inflation accelerates and the corporate tax rate is raised. Wholesale sellers will immediately request rate increases, which will, by law, become effective after five months.

Compare the performance of FERC to that of the state public utility commissions in effecting rate decreases. NASUCA members have pursued rate reductions before state public utility commissions across the country. Frankly, we have met with mixed success. Some state commissions have been willing to move faster and cut rates deeper than others. Nevertheless, it is unlikely that any state will delay reducing rates two years with no right to a refund, as is possible before FERC.

The existence of legal mechanisms to pass quickly on rate reductions can be a powerful negotiating tool, even if never used. My own state of Illinois provides a good example. The

Illinois Public Utilities Act authorizes the Illinois Commerce Commission to reduce rates immediately upon determining that a utility's rates are excessive. Hearings can then be held to establish the evidentiary justification for the rate reduction and the prospective level of permanent rates. The threat of use of that provision has encouraged utilities in Illinois to reduce their rates voluntarily to reflect the declining costs. FERC has no such club to hold over the utilities it regulates. Therefore, voluntary reductions will be few and will be of minimal value to ratepayers.

Finally, I would like to point out the beneficiaries of the Regulatory Fairness Act of 1987. These include customers of public power systems, customers of rural electric cooperatives and customers of investor-owned utilities. The rates of this latter group are increasingly falling under FERC jurisdiction. Some investor-owned utilities, such as the Culf States utilities and the Yankee Atomic companies, have corporate structures that result in wholesale purchase of power from corporate affiliates. Recently, other investor-owned public utilities have attempted to escape from state regulation by spinning off their generation facilities into separate subsidiaries and then contracting to purchase power from those facilities at a FERC determined rate. Last year, Tucson Electric Power Company spun off a wholesale generating company independent of the utility. The New Mexico Public Service Commission is currently considering a request by Public Service Company of New Mexico to form a master limited partnership to whom it will sell its distribution system. The existing corporation would then be solely in the business of generation and transmission of electricity. The Illinois Commerce Commission recently denied a request of Commonwealth Edison Company to spin off three new nuclear plants into a generating subsidiary and to enter into purchase power contracts subject to FERC regulation.

Consumer advocates believe that one of the reasons that utilities may be attempting to trade state regulation for FERC regulation is that the utilities feel they will obtain more favorable regulation by making that switch. The lack of the availability of refunds in rate decrease proceedings is one example of the relative deficiency of FERC regulation. Enactment of the Regulatory Fairness Act of 1987 would close this gap between federal and state regulation of public utilities. Additionally, passage of this bill would signal the first step toward discouraging FERC from placing any wholesale rate change under bond.

It is my understanding that the bill that emerged from the House of Representatives is a consensus bill. NASUCA encourages your support of that consensus legislation without further amendment which dilutes the regulatory equity we seek.

I would like to close by acknowledging that consumer advocates such as NASUCA members will accept the burden of pursuading FERC to exercise the authority to grant refunds. All we are asking is that you give us the chance to make that argument.

Senator **Bumpers**. Thank you, Mr. Moore.

Mr. Mundy.

STATEMENT OF RODNEY O. MUNDY, PARTNER, BALCH & BINGHAM, ON BEHALF OF THE EDISON ELECTRIC INSTITUTE

Mr. **Mundy**. Thank you, Mr. Chairman.

My name is Rod Mundy. I am a member of the law firm of Balch & Bingham in Birmingham, AL. That firm represents Southern Company Services and Alabama Power Co., and I have been asked today to present the views also of the Edison Electric Institute.

I must say to you right off the bat that I am at somewhat of a disadvantage. That is, two statements today, one, that EEI has found the bill to be acceptable, that is, the House-passed version of the bill; and that EEI agreed to the bill. That is not my understanding of EEI's position, to be precise. I was not privy to those discussions, so I cannot say from my own personal knowledge what EEI did or did not agree to in those negotiations. But as explained to me, and as set out on the bottom of page 1 and the top of page 2 of my testimony here, certainly EEI believes that it made clear that each of its member companies was to be given the opportunity when the bill came before the Senate to present its views and ask for further amendment. And certainly EEI thought it was reserving the position to do that.

Now, I would like, if I could for a minute, address S. 1567. I think my concern with the legislation and EEI's concern with the legislation can be reduced to one word, risk. And we are going to be facing additional risk. And this is not a good time for the utility industry to be assuming more risks and driving our costs up.

Now, in that regard I would like to explore with you two examples today. One is on the unlimited refund obligation that the bill would impose on utilities, and the second is the absolute need of utilities, and requirement for utilities, certain utilities, to have certainty with respect to sales they are making to other utilities and to know what their revenues are, and not have those revenues subject to question.

Now, you are going to hear a lot of accounting jargon, you are going to hear a lot of legalese, and I will probably participate in that.

Senator **Ford**. The first or the latter? [Laughter.]

Mr. **Mundy**. Probably both.

Senator **Ford**. Oh, OK.

Mr. **Mundy**. I am often found guilty of both.

But in any event, I really think the risk here can be demonstrated by a simple analogy. Let's suppose I went to my banker, which I often do, and ask for a loan. And the banker says, all right, Mr. Mundy, here is a form; fill it out. He says, fill out how much income you have got. And I do that. And then I fill out your liabilities. And then he looks down at me and says, now, okay, it looks like your income will support this little loan that you want to make, that is fine, we will make it to you. And I say, oh, but one more thing. I have got to tell you, my partners are going to review my performance here at the end of the year, and they may make me refund all of my wages.

Now, the banker is going to say, wait a minute, that is a risk you did not tell me about. That is precisely what this bill is doing to the utility industry. It is adding additional risk.

It is not something that we are making up; it is not something that we have invented so we could dupe poor customers out of their money out there, it is not there at all. It is substantial, real risk. And I think the example shows that.

Now, the other thing, I am talking about pooling and interconnection arrangements. Utilities through the years, and the Federal Power Act, the greatest thing it has done is to encourage utilities to interconnect their facilities, provide for transactions between them, economical transactions between them, and it fosters those transactions.

Now, let's suppose you have four utilities, A, B, C, and D, and they are in a pooling arrangement. That is, they commit their generation, their energy to support the other utilities when it needs generation or when it needs energy, and that utility pledges to do the same thing. And they have an agreement on file with the FERC that says, all right, in doing this, when you are short of generating units, Utilities C and D, you are going to buy from A and B at a particular rate. Okay.

So A and B are selling portions of generating units, I mean capital-intensive generating units, to utilities C and D. Somebody files a complaint, I do not know who that somebody is, under 206 of the Federal Power Act. FERC establishes a refund effective date, and sometime down the road FERC says you are right. A and B, you should have kept those two generating units for your own customers. You should not have been selling them to C and D. And C and D, you should not have been buying them.

All right, now, what happens? Well, under most States' law, C and D will get a big refund, Utilities C and D, a windfall for their stockholders, because under most States' law, and this is not true of all State law, but it certainly is the ones I am familiar with, there is no requirement to make a refund in that situation. It has had its set rates out, there is no requirement.

What do Utilities A and B do? Well, they say, wait a minute, I have to go back to my commission now. The FERC said these generating units should have been covered by my retail and wholesale costs.

Well, I can tell you where that is going to go. Nowhere. You are not going to get them covered retroactive from your State commissions. They are not going to allow that, and I do not blame them.

We need to have some degree of certainty with respect to pooling transactions and interconnection agreements.

EEI and I said in the House testimony that I do not have major concern with a bill that provides some kind of protection for municipalities and cooperatives that are captive customers of big investor-owned utilities that do not have the wherewithal to battle them.

Okay, maybe the bill is needed to do that. But the bill goes far beyond all that, and the scope of the bill is just too wide. It needs to be improved. The House version improves it. I suggest to you that—and the other people who will speak after me are going to suggest additional improvements to decrease the risk, not to do away with what you want to do, but just decrease the risk on the utilities.

Thank you, Mr. Chairman and members of the committee.

[The prepared statement of Mr. Mundy follows:]

TESTIMONY OF RODNEY O. MUNDY
ON BEHALF OF THE EDISON ELECTRIC INSTITUTE
BEFORE THE SENATE COMMITTEE ON
ENERGY & NATURAL RESOURCES
CONCERNING S. 1567
November 18, 1987

Mr. Chairman:

My name is Rodney O. Mundy. I am a partner in the law firm of Balch & Bingham in Birmingham, Alabama, which firm serves as general counsel for Southern Company Services, Inc. and Alabama Power Company. I am here today to present the views of the Edison Electric Institute (EEI).

The Institute is the association of electric companies. Its members serve 96 percent of all customers served by the investor-owned segment of the industry. They generate approximately 75 percent of all the electricity in the country and service 73 percent of all ultimate customers in the Nation.

On October 7, 1987, I had the privilege of presenting the views of EEI in a hearing before the House Subcommittee on Energy and Power concerning H.R. 2858, the House companion measure to S. 1567. Accordingly, much of what EEI presented in testimony before the House Subcommittee is applicable to S. 1567. On October 14, 1987, the Energy and Commerce Committee of the House approved H.R. 2858 and on October 27, 1987 the House passed the bill. The full Committee amended H.R. 2858, producing a measure that is different from S. 1567. In EEI's view, the amendments improved the House version of the bill, as many of the changes came as the result of work between the utility industry and supporters of the House bill. While there was not a resolution of all the problems, EEI accepted the compromise as the best arrangement that could be achieved within the time constraints. Some member companies will be severely impacted by this legislation. There was an attempt by these companies and the Subcommittee to reach agreement, but there was not sufficient time to resolve all of their concerns. It was understood that these companies would submit comments to this Senate Committee. Representatives of those companies are here today.

Today, therefore, I would like to discuss the Senate bill by, in part, comparing and contrasting it to the amended version of H.R. 2858.

EEI appreciates the concerns and understands the goals of the sponsors of S. 1567, for on its face the bill would appear simply to balance the ability of wholesale customers to obtain rate decreases with the ability of public utilities to obtain rate increases. The bill, however, places additional and substantial financial risks upon public utilities. By imposing these new risks, S. 1567 alters a regulatory balance that has been in existence since the enactment of the Federal Power Act (FPA) over fifty years ago. Moreover, as presently drafted, the bill could lead to procedural abuses and needless disruption of the regulatory process.

Also, the sponsors' expressed concerns about current wholesale electric rates are already being addressed by the Federal Energy Regulatory Commission (FERC) under existing law.

Therefore, after careful review, EEI finds that S. 1567 is flawed. Although EEI has deep reservations about the wisdom of amending Section 206 of the FPA, EEI and its members would have far fewer concerns if (1) the amendments made to H.R. 2858 were incorporated in S. 1567 and, (2) certain additional problems faced by some EEI members were addressed during Senate consideration of this measure.

As an initial matter, EEI notes that the supporters of S. 1567 have stated that amendments to Section 206 are needed because fluctuations in interest rates, changes in the tax laws, and reductions in construction costs have created a "regulatory lag" between cost reductions and rate decreases. In recent years, changes in the tax code and reductions in the cost of capital have tended to offset otherwise increasing costs and, thus, in some instances lower the costs of providing service by some electric utilities. FERC has successfully and expeditiously dealt with both of these changes. First, the recent reduction in the federal corporate income tax rate lowered the tax expenses of utilities. FERC responded to the lower tax rates by swiftly producing a rulemaking that would adjust rates to reflect decreases in tax expense. (Order No. 475, Docket No. RM87-4, 52 Fed. Reg. 24987 (July 2, 1987)). Specifically, this rule established voluntary, expedited filing procedures whereby utilities, using a formula prescribed by FERC, were strongly encouraged to reduce their charges to reflect the new, lower federal tax rates. Electric utilities are to file in alphabetical order; filings by the last group of utilities are due by November 30 of this year. Thus, FERC has taken steps to flow through the full benefit of tax reductions even though many utilities have experienced cost increases in other facets of their operations that more than offset reductions in the federal income tax rate.

The industry's current, lower capital costs have been dealt with through individual Section 206 investigations. FERC has made a determined and successful attempt to process these cases expeditiously. On September 30, 1987 the Commission reached final decisions in three of these cases. The cases were processed in approximately six months. Moreover, these cases were complex and involved issues other than the cost of equity capital. (Connecticut Yankee Atomic Power Corp., Docket No. EL87-23; Vermont Yankee Nuclear Power Corp., Docket EL87-22; Yankee Atomic Electric Co., Docket No.EL87-21. 40 FERC 61,372 (1987))

The decline in the cost of capital has not only halted; that cost now appears to be on the increase. FERC's quarterly benchmark cost of equity reached its lowest point three quarters ago, and has since risen 107 basis points to 12.27%. It can be expected to go higher due to recent market conditions. All of this is not to say that the electric utility industry is entering a long new period of rising cost of service. Cost of service indeed may decline in the next few years, but FERC has demonstrated that it can protect wholesale customers against regulatory lag during periods of declining cost, and there is no reason to believe that it will fail to do so in the future. Therefore, EEI concludes that legislation to protect wholesale customers against so-called regulatory lag is simply unnecessary.

Before turning to a more detailed discussion of the problems apparent in the bill itself, we think it necessary to examine briefly Sections 205 and 206 of the Federal Power Act as they now exist and operate. These two sections, with very minor amendments, have been part of the FPA since FERC's predecessor, the Federal Power Commission, was first given jurisdiction to regulate wholesale rates in 1935. At the time of the enactment of the FPA, electric wholesale transactions in interstate commerce were completely unregulated.

Section 205 establishes several basic principles of federal electric utility rate regulation. It begins with the requirement that rates be just and reasonable, and declares that any rate that is not just and reasonable is unlawful (Subsection a). It then forbids discriminatory and preferential rates (Subsection b). Next, the section requires that utilities file all wholesale rates with the Commission (Subsection c). It requires prior Commission approval for any rate change (Subsection d) and establishes procedures for the review of rate change applications (Subsection e).

The underlying purpose of Section 205 is clear: wholesale electric rates and terms are to be just, reasonable, and nondiscriminatory. The Commission's role under Section 205, if it can be characterized briefly, is to exercise oversight and review of the rates, charges, terms and conditions of jurisdictional contracts.

Subsection 206(a), on the other hand, allows the Commission to revisit already established rates to determine whether they are "unjust, unreasonable, unduly discriminatory or preferential," and, if found to be so, to "determine the just and reasonable rate . . . to be thereafter observed and in force, and [to] fix the same by order." The legislative history of the FPA reveals that Congress deliberately withheld from the Commission "the power to award reparations on the ground that a properly filed rate or charge has in fact been unreasonably high or low." Montana-Dakota Utilities Co. v. Northwestern Public Serv. Co., 341 U.S. 246, 254 (1951) (Frankfurter, J. dissenting on other grounds). In fact, Congress specifically eliminated a section of the Federal Power Act that would have authorized "the issuance of reparation orders." Pub. Serv. Co. v. Federal Energy, Etc., 600 F.2d 944, 957 (D.C. Cir. 1979) (citing S.Rep. No. 621, 74th Cong., 1st Sess. 20 (1935). Why, in enacting Section 206, did Congress choose to deny retroactive relief in the form of refunds for charges found not to be just, reasonable, or fair? Likewise, one might ask, why, despite repeated proposals to do so, have past Congresses not amended Section 206 to provide for such refunds?

Edison Electric Institute believes that the answer to these questions is found in the nature of the regulatory balance embodied in the Federal Power Act. Recognizing that as in any business, revenues are the lifeblood of the electric industry. Congress embraced the idea that once a rate is filed with and accepted by FERC (under Section 205) it should be the only lawful rate. Thus, Congress ensured that once FERC had passed on the "justness and reasonableness" of a filed rate, a utility would, despite the provisions of Section 206, at least have the certainty of knowing that rate could be relied upon to produce revenue until it was otherwise demonstrated that the rate had fallen out of the so-called zone of reasonableness. Therefore, in implying unfairness in the fact that the remedies of Section 206 do not mirror those of Section 205, the proponents of S. 1567 ignore congressional efforts to counterbalance in Section 206 the inherent delays and costs imposed on the utility industry by Section 205.

The fact that a rate change processed under Subsection 205(e) may be implemented subject to refund, whereas a reformed rate implemented by FERC under Subsection 206(a) is prospective only, is also consistent with other regulatory schemes, such as the Natural Gas Act (15 U.S.C. 717(e) and 717(a)) and the Communications Act (47 U.S.C. 204(a) and 205(a)). In these and other statutes, Congress has recognized that regulated industries should be able to rely on the lawful established rate and not be subjected to the additional risk that revenues collected under that rate may be made subject to refund. Not surprisingly, the courts have recognized that this balancing effort does not create unfairness. For instance, one federal court (relying upon pronouncements of the United States Supreme Court) provided the following thoughtful analysis of the policy underlying Section 206 of the FPA:

> The Congressional decision not to allow the Commission to determine retroactively what would have been a reasonable rate and award the difference between that and the filed rates was a deliberate one. [Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246, 251, 253-4 (1951).] In the Federal Power Act, as in other rate regulation areas where similar schemes have been adopted, Congress sought to strike a balance between the seller and its customers. T.I.M.E., Inc. v. United States, 359 U.S. 464, 479, 79 S. Ct. 904, 3 L. Ed. 2d 952 (1959) (interpreting a similar regulatory structure in the Motor Carriers Act). While the right to award reparations to purchasers was withheld, the utilities' preexisting rights to set its own rates and put them into effect were significantly curtailed. Any change in rate requires thirty days notice and the Commission may thereafter suspend the effectiveness of the change for five months. Even after the five months have passed the commission may require the utility to take the necessary steps to be able to refund any portion of the increase ultimately found to be unjustified.

City of Newark v. Delmarva Power & Light Co., 467 F. Supp. 763, 771-2 (D. Del. 1979). In other words, Congress in enacting Section 206, weighed competing interests and produced a statute that, although placing substantial new risks on electric utilities, provided assurance that revenues collected under a lawful rate would not be subject to refund. Congress did not create an inequity or imbalance between wholesale suppliers and their customers when it enacted Title II of the Federal Power Act; rather it balanced those interests.

In a Section 205 rate proceeding, it is clear that a utility's refund liability has a floor. That floor is the "last clean rate" to which FERC has given final approval. Cf. FPC v. Sunray DX Oil Co., 391 U.S. 9, 21-24 (1968) (construing parallel provision in Natural Gas Act). A Section 206 inquiry, however, is not so limited. The rates and all conditions of service may be made an issue in a 206 proceeding, and FERC may make any change it deems necessary to render the utility's rates just and reasonable.

Accordingly, unless FERC is required to set a limit to a utility's liability in advance, it would be impossible under the provisions of S. 1567 for anyone to know the amount of revenue that a company may be required to refund. This type of uncertainty could have a serious effect on a utility's financial integrity. For utilities that have only a small portion of their revenues regulated by FERC, the effect may not be a major concern. For a utility with substantial amounts, or all, of its revenues subject to FERC jurisdiction and possible refunds -- and there would be many such utilities -- this type of financial risk could prove to be financially disastrous. In the worst case, a complex and involved 206 proceeding could put at risk much of a utility's revenue. This would impair the quality of earnings, leading perhaps to qualified financial statements. These qualified statements, or concurrent reductions in retained earnings, could trigger the provisions of a public utility's charter or first mortgage indenture that provide for certain levels of "good" earnings before additional preferred stock or debt can be issued by the public utility. These provisions, commonly known as coverage requirements, are incorporated in charters and in first mortgage bond indentures of almost all public utilities.

Short of this worst-case scenario, the risk created by potential refund liability would no doubt create negative perceptions among investors in electric utilities that rely primarily upon FERC-regulated revenues. In turn, these utilities would face increases in the cost of capital, leading to higher utility rates -- a result that is, of course, opposite to that intended by the sponsors of S. 1567. These consequences would be worse for single-asset utilities. The FERC has decided Section 206 cases for four such utilities this year: Allegheny Generating Co., Connecticut Yankee Atomic Power Corp., Vermont Yankee Nuclear Power Corp. and Yankee Atomic Electric Co.

As outlined above, and as others will testify, a principal objection to S. 1567 is that it would expose utility companies to substantial, added financial risk. Given the nature of a Section 206 investigation, the bill would do this by creating potentially unlimited liabilities for refunds to wholesale customers. The House bill, as amended, does not address this inherent problem in the legislation. This problem could be resolved by requiring the FERC to set a reasonable floor under a utility's potential refund obligation. FERC, in its order instituting a proceeding and establishing a refund effective date, could establish the limit of the utility's refund liability. This floor would be based upon the complaint, the utility's answer, and the evaluation of FERC's staff pursuant to standards established by the Commission.

EEI requests permission to submit an Exhibit for the record that analizes the impact of S. 1567 on utility financial statements. This analysis examines, among other things, the relationship between the lack of a refund liability floor and the need for auditors to qualify financial statements.

EEI believes that S. 1567 should also be amended so that the proponent of changed rates retains the burden of proof that the existing rates are unjust, unreasonable, discriminatory or preferential. This would confirm that Congress intends no change in existing law in this regard. This type of provision is found in Section 2 of the House bill and EEI commends it for adoption by the Senate.

Importantly, because a Section 206 investigation can be instigated so easily and cheaply, EEI is concerned that potential complainants after the enactment of S.1567 will have no incentive to refrain from filing insubstantial and repetitious claims. When a utility files for a rate increase under Section 205, FERC's regulations impose very detailed filing requirements. Preparation of a filing to justify a rate increase can take six months or more. Moreover, the filing is voluminous and, of course, expensive to compile and support. In contrast, there are no comparable filing requirements related to a Section 206 complaint. In other words, S. 1567 would provide anyone a no-risk means of imposing a tremendous burden on a wholesale supplier of electricity. The House took some steps toward solving this problem by requiring that a 206 complaint must "state plainly and to the extent practicable the change or changes to be made . . . and the reasons for any proposed change or changes."

The bill, as drafted, also contains a provision that would permit a complainant in a Section 206 case filed after July 1, 1987 to obtain, by refiling, the benefits of S. 1567. It is unclear whether this provision is designed to provide for the setting of retroactive refund dates. If S. 1567 is designed to be retroactive, the provision is completely unfair. The bill, if enacted into law, should be effective only as to Section 206 complaints filed after it is enacted. The House apparently recognized the unfair and confusing nature of this provision and by amendment struck it from H.R. 2858.

Finally, the proponents of S. 1567 and H.R. 2858 are seeking to protect the interests of wholesale requirements customers that purchase all or part of their electric power from investor-owned utilities. Under the proposed legislation, *any* wholesale contract under the FPA would be subject to risk, not simply those contracts involving sales to such customers. Thus, wholesale agreements between major investor-owned utilities and even power exchange contracts among affiliated utilities could be disrupted by third parties seeking, through Section 206, refunds in the "public interest." *FPC v. Sierra-Pacific Power Co.*, 350 U.S. 348, 355 (1956).

Under the Federal Power Act the FERC is directed to encourage interconnection and economical power exchanges both within and between regions of the country. 16 U.S.C. 824a (1978). Thus, electric utilities, for reliability purposes, have voluntarily established substantial electrical interconnections. As the result of these interconnections, major affiliated and nonaffiliated utilities exchange substantial amounts of power to gain economic efficiency. In the main, these are voluntary transactions entered into by electric utilities with relatively equal bargaining power. Refund liability, even if it made sense in this separate and distinct market, could only discourage electric utilities from entering into transactions that the Federal Power Act is designed to foster and that economically benefit all consumers.

Conclusion

I thank the Chairman and the members of the Committee for the opportunity to testify on this important issue and present the concerns of EEI members. To summarize:

> EEI appreciates the concerns of the sponsors of S. 1567;
>
> However, EEI has the following concerns: 1) S. 1567 creates additional financial risks for utilities; 2) the legislation is unnecessary to protect the interests of wholesale purchasers, and; 3) it is too broad in scope.
>
> At a minimum, certain important safeguards should be added to S. 1567; and,
>
> EEI would welcome the opportunity to work with the Committee to make improvements in S. 1567.

Senator BUMPERS. Thank you, Mr. Mundy.
Jerry.

STATEMENT OF JERRY D. JACKSON, SENIOR VICE PRESIDENT, MIDDLE SOUTH UTILITIES SYSTEM

Mr. JACKSON. Thank you, Mr. Chairman.

For the record, my name is Jerry Jackson. I am with the Middle South Utilities System.

First of all, I want to state I appreciate the opportunity to visit before this committee and testify in connection with this proposed legislation. I should emphasize that I am speaking today only on behalf of the Middle South Utilities System and not the electric industry in general.

I have submitted written testimony for the record, so I will attempt simply to orally summarize that testimony for you today, Mr. Chairman.

I should first point out that Middle South Utilities System serves four states, Missouri, Arkansas, Louisiana and Mississippi through our four operating company subsidiaries. Our system is particularly concerned about this legislation because a great deal of our system's revenues are subject to FERC jurisdiction. Our operating companies exchange power as a part of an integrated, coordinated utility system. They use a power pooling agreement. They use central dispatch of all generation resources so that the lowest cost generation anywhere on the system is used to satisfy that next increment of need anywhere on the system.

And all this is accomplished under a pooling agreement which the purchases and sales are subject to FERC regulation. In addition, our operating companies purchase power from another subsidiary company from the Grand Gulf Nuclear Station, which is also subject to an FERC rate schedule.

As a result of these purchases and sales under the pooling agreements and these intersystem agreements, an extremely large portion of our total system revenues is subject to FERC jurisdiction, and that is the reason for our concern.

To summarize our testimony, I would first state that we do not believe there is a need for this legislation. I think I should point out that the title of the bill, the Regulatory Fairness Act, the statements that have been made that indicate that there is something unfair with respect to the distinction between a refunding obligation under section 205 and an implementation of a reduction under 206 prospectively is somehow inequitable or unfair.

Mr. Chairman, in this connection, I think it must be recognized that there is a distinction between a 205 filing and a 206 filing. A complaint under 206 challenges a rate that has been previously approved or allowed to become effective pursuant to an FERC determination. Accordingly, until it is determined by the FERC that that rate, which the FERC has approved or allowed to become effective, is no longer just and reasonable, the utilities should be permitted to rely on the certainty of the revenues produced by that rate schedule.

Now, under a 205 rate filing, that is a different situation entirely. A 205 proposes a change, an increase to a previously approved rate schedule that has been approved by the FERC. Obviously, if you are dealing with a change to a rate that has been previously approved by the FERC, then that rate, if collected, should be collected subject to refund.

But in both cases, the rate that has been previously approved or allowed to become effective by the FERC remains unchanged until it makes a subsequent determination that that rate is no longer just and reasonable. We believe 205 and 206 proceedings are consistent in that regard. They both recognize that in order for a utility to finance, it must have some certainty as to the revenues produced by its rate schedules.

We have two basic concerns with this proposed legislation, Mr. Chairman. If it is determined that some change in the law is to be made, we believe, one, the bill should be amended to exclude pooling agreements, interconnection agreements, joint ownership or intrasystem agreements. These are not typically the wholesale agreements between a utility company and a customer that would involve purchasing utilities such as represented by the APPA and other organizations.

Secondly, we believe this legislation should have some reasonable ceiling on the amount that would be refunded in the event of a 206 proceeding.

Senator FORD. Mr. Jackson, would you call that a floor rather than a ceiling?

Mr. JACKSON. The amount of the refund, I suppose, would be a ceiling; if you are having a level of rates, that you could refund down to, I suppose that would be a floor.

But when we are talking about the amount that could be refunded, I think there should be a ceiling on the amount that could be refunded.

Our amendment provides that at a very minimum, the utility should be able to count on that level of revenues which, under its coverage requirements, it must be able to demonstrate to its accountants, the financial community in order to sell new bonds, new securities, at a minimum it should have that amount of revenues that are not subject to refund.

We think that is consistent with the law which one of the principles of utility regulations, the utility should have a level of rates adequate to allow it to attract capital. In order to attract capital, you must be able to satisfy your coverage requirements.

So when we are dealing with a change to where rates that have been previously approved by the FERC, we think as a minimum there should be that ceiling or that floor that would not permit a refund that would jeopardize your building and your coverage requirements.

Mr. Chairman, that summarizes our two basic concerns. I should share one other concern. I believe that this legislation will result in increasing the cost of capital to the utilities because of the additional risk that has been discussed today. I cannot address that with any real expertise because I am not a financial expert. I am concerned that the committee is not receiving testimony from the financial community or the accounting community with respect to what impact this legislation might have on the risk for the electric utility industry, the cost of capital, which are ultimately going to be borne by not only utility companies but their customers.

I would hope and suggest that this committee would schedule at least one other day of hearings where it would hear witnesses from the financing and accounting community with respect to the impact of this bill.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Jackson follows:]

TESTIMONY OF
JERRY D. JACKSON
ON BEHALF OF THE MIDDLE SOUTH UTILITIES SYSTEM
BEFORE THE SENATE COMMITTEE
ON ENERGY AND NATURAL RESOURCES
CONCERNING S. 1567

November 18, 1987

MR. CHAIRMAN:

My name is Jerry D. Jackson, and I am Senior Vice President-Legal and External Affairs for the Middle South Utilities System. The Middle South System is one of the largest investor-owned electric utility systems in the country. Through our four local operating companies, each of which has a separate area of service, the Middle South System serves many classes of electrical customers in the states of Louisiana, Arkansas, Mississippi and Missouri. In order to achieve the lowest possible cost of power and energy within our system, our operating companies exchange power among themselves and centrally dispatch generating units throughout the system pursuant to a complex power pooling agreement. This power pooling agreement is subject to the Federal Energy Regulatory Commission's (FERC) exclusive jurisdiction under the Federal Power Act (FPA). Furthermore, our operating companies also purchase nuclear power from another Middle South affiliate which owns and operates a large nuclear generating station, the Grand

Gulf Station, near Port Gibson, Mississippi. These purchases are also pursuant to an FERC-regulated agreement which supplements the power pooling agreement.

These two agreements - Middle South's power pooling agreement and the Grand Gulf agreement - together with a number of agreements providing for the sale of power and wheeling service by our local operating companies to non-affiliated public utilities as well as municipally and cooperatively owned wholesale customers, mean that an extremely large portion of our system's revenues are subject to regulation and adjustment by the FERC. This fact raises our primary concern with S.1567, the Regulatory Fairness Act, particularly as drafted, and likewise with H.R. 2858 as passed by the House. This legislation could make an enormous part of our revenues, which are our financial bloodstream, subject to refunding for potentially long periods of time simply by the filing of a complaint which may or may not have merit.

Since regulatory lag can be and has been a two-way street, sometimes temporarily benefitting consumers over stockholders and sometimes vice versa, I appreciate the concerns which motivate the chief proponents of this legislation. Nevertheless, I would like first to point out why the Middle South System firmly believes, based on actual experience, that the present and longstanding complaint procedures under Section 206 of the FPA now serve to protect consumers. In September of 1986 the Louisiana Public Service Commission filed a complaint against us at FERC under Section 206 of the FPA. The Complaint alleged that the allowance of 16% for rate of return on equity included in our power pooling and Grand Gulf agreement had become excessive over time as a result of changes in various economic and risk considerations, such as declining interest rates and the fact that we had succeeded in getting our first Grand Gulf nuclear unit into commercial operation. The complaint was set for hearing by the FERC. The Section 206 hearing procedures produced difficult but good faith settlement negotiations in which the state commissions of Arkansas, Mississippi and Louisiana, among other prominent local officials and interest groups, participated. Those negotiations led to a settlement agreement in which Middle South agreed to lower its rate of return on equity to 14%, effective as of July 1, 1987, and further that the lowered return would remain unchanged until January 1, 1990. The settlement agreement was promptly approved by the FERC as clearly being in the public interest.

There are several key points that should be realized when assessing how well consumers were protected by the FPA as it now stands. First, no refunding condition of the type included in the legislation was necessary to promptly generate the settlement, which, as I just mentioned, also prevents us from increasing our equity return allowance for several years to come. Second, while there might have been a brief period of time when declining interest rates raised questions with respect to the continued justification for a 16% return and which resulted in an agreed reduction to 14%, by the time the settlement agreement had been concluded, economic and risk conditions had swung back the other way. I believe that our current costs of capital, due to the imposition of enormous regulatory risk and deteriorating economic and market conditions, is higher than the 14% allowance reflected in our power pooling and Grand Gulf agreements.

Over the long run, the existing balance between Sections 205 and 206 of the FPA has ensured that our consumers have not paid excessive rates for FERC regulated power purchases while recognizing our need, and the need of other electric utilities, for stability and predictability of revenues in order to be able to continue to provide reliable service. I would add that there is no reason to believe that our recent experience with Section 206 complaint procedures is atypical, or that overcollection of revenues from electric utility customers for extended periods is a major problem in our nation.

Now I would like to point out why we believe that enactment of the proposed legislation would create unfairness, not fairness, and why ultimately both our consumers and stockholders will be hurt, despite the good intentions of its sponsors. This legislation will likely encourage the filing of insubstantial complaints simply because the potential economic and political payoffs are large while there is practically no risk and little cost in losing. Possible dismissal of a frivolous complaint filed pursuant to Section 206 does not carry the stigma or consequences that is carried by rejection of an unsupported and unjustified request by a public utility for a rate increase under Section 205. Fundamentally, it is much more difficult for a public utility to prepare for and properly time the filing of a rate increase than it is to file a complaint seeking lower rates since the public utility must balance the need for revenues essential to maintain reliable service against public reaction to rising electricity costs.

It should be recognized that there is a distinction between a rate increase under Section 205 and a complaint filed under Section 206. This distinction justifies the difference in refund requirements under present law.

A complaint filed under Section 206 challenges the continued effectiveness of a rate previously approved or allowed to become effective by the FERC. Accordingly, until the rate is determined to be unjust and unreasonable, the utility should be permitted to rely on the continued effectiveness of previous approved or effective rates until a determination by the FERC to the contrary.

Under a Section 205 proceeding, the utility is proposing a change to the previously approved and effective rate. Accordingly, there is justification for the unapproved increase or change in rates to be collected subject to refund until determined to be just and reasonable by the FERC.

Thus, there is no real inconsistency between existing Section 205 refund requirements and the lack of refund requirements under Section 206 under current law. In both cases, rates which have been approved or allowed to become effective by the FERC are not clouded by a refund requirement through the unilateral, and perhaps unmeritorious, filing of a complaining party.

Further, unlike the current refund provision for increases under Section 205, there is no equivalent balancing of interests between consumers and utilities in the imposition of a refund requirement under Section 206.

The refund condition imposed by the FPA for proposed rate increases under Section 205 serves to protect both consumers and electric utilities regardless of the outcome of the proceeding and is therefore in the public interest. In contrast, while the refund condition in this proposed legislation would increase regulatory protection of consumers, the imposition of a refund requirement by its presence alone will necessarily result in harm to electric utilities, even if after a hearing the complaint is found to be without merit and no refunds are ordered. The financial strength of electric utilities will necessarily be harmed because an unspecified amount of their revenues will be exposed at any time to potential refunding with interest. The cloud of uncertainty will hang over their financial reports until the case is finally resolved thereby imposing additional financial risk even in those cases where the complaint has no merit. Therefore, in the long run, since the cost of capital will rise to offset the increased financial risk, everything else equal, the refund condition in the legislation will impose higher costs on electric utilities and their customers and, for that reason, this legislation is contrary to the public interest.

Since a complaint procedure which automatically establishes the possibility of large refunds will be easy to file and will always receive popular support among consumers, there will be enormous pressure on state and local regulators to have their lawyers and consultants file complaint after complaint. It will also be difficult as a matter of federal-state comity for the FERC to summarily reject even the most baseless or speculative complaint. Therefore, the legislation promises to significantly increase the regulatory workload of the FERC and electric utilities at a time when the overall emphasis should be on less regulation, not more.

As Mr. Rodney O. Mundy has testified on behalf of the Edison Electric Institute, the legislation also creates an economic incentive for a potential complainant to "take a shot in the dark" or speculate on the riskless chance that a complaint eventually could reduce the targeted utility's rates. For example, a party could file a complaint, knowing it to be baseless, but speculating that interest rates or other economic or structural changes eventually would give the complaint plausibility. Since, however, the Commission would have already established a refund effective date, a portion of the relief would be an undeserved windfall.

Another major concern that we have is that the legislation does not distinguish between the wholesale service agreements with "traditional" wholesale customers such as cities and towns who own their own electric distribution systems on the one hand and voluntary agreements in the nature of an interconnection, power pooling, intra-system, joint electric facility ownership or coordination agreement, operating across state lines, between or among affiliated or non-affiliated public utilities, on the other hand. The latter category of agreements often poses more difficult and complex regulatory issues than the former. The latter type of agreements are not the typical utility and customer agreements but are instead voluntary exchange agreements which commonly include reciprocal buy and sell arrangements. Under these agreements, rates are established for power which is both purchased and sold by the contracting utility. Failure to exclude the latter category threatens the stability of these interstate arrangements which are delicately balanced to spread the benefits and burdens of power supply coordination on a regional basis. Parties to power pooling agreements, for example, may be exposed to numerous conflicting and overlapping complaints by regulatory officials in competing states.

For the reasons I have discussed, the Middle South System urges the Committee not to act favorably on the legislation. If the Committee nevertheless decides to report the bill, I would then urge that certain amendments be made to address the most significant concerns that we have. First, these amendments would ensure that the FERC could not impose refunds in a complaint proceeding addressing an agreement in the nature of an interconnection, power-pooling, intra-system, joint electric facility ownership or coordination agreement. Second, we believe that the legislation should set some reasonable ceiling on the amount of revenues that could be rendered subject to refund by the simple filing of a complaint such as by ensuring that the refund would not jeopardize a utility's ability to meet its financial coverage ratio tests necessary to enable it to finance and issue new securities. Additionally, although FERC has the power to grant summary dismissals on the basis of pleadings only, it is extremely difficult for the FERC to dismiss even the most frivolous of complaints filed by public officials. We therefore recommend amendments to reinforce FERC's authority to dismiss insubstantial complaints and to limit the number of complaint proceedings against any one public utility which result in the establishment of a refund effective date during a particular period of time. Attached to my written remarks is a markup of the House-passed legislation which contains recommended language to accomplish these amendments. Several technical amendments are also included in the attachment.

I thank the Chairman and the members of the Committee for the opportunity to testify on this important issue.

ATTACHMENT

Section 1. SHORT TITLE.

This Act may be cited as the "Regulatory Fairness Act".

Section 2. REFUNDS IN PROCEEDINGS UNDER SECTION 206 OF THE FEDERAL POWER ACT.

Section 206 of the Federal Power Act (16 U.S.C. 824e) is amended as follows:

(1) At the end of subsection (a) insert: "Any complaint or motion of the Commission to initiate a proceeding under this section shall state plainly, to the extent practicable, the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. The public utility shall file with the Commission an answer to such motion or complaint and shall specify therein its reasons for disagreement, if any, with the motion or complaint. If, after review of any motion or complaint and answer, the Commission shall decide to hold a hearing, it shall fix by order the time and place of such hearing and shall specify the issues to be adjudicated. The Commission is authorized to summarily dismiss frivilous, insubstantial or speculative complaints on the basis of the filed complaint, answer and any other pleadings permitted by the Commission's Rules of Practice and Procedure. Any such dismissal shall be with prejudice against the filing of a similar complaint by the same party or similarly situated parties within the next subsequent twelve month period."

(2) Designate subsection (b) as (d) and insert the following new subsections after subsection (a):

(b) Whenever the Commission institutes a proceeding under this section, the Commission may establish a refund effective date. In the case of a proceeding instituted on complaint, any refund effective date shall not be earlier than the date 60 days after the filing of such complaint nor later than 5 months after the expiration of such 60-day period. In the case of a proceeding instituted by the Commission on its own motion, the refund effective date may not be earlier than the date 60 days after the publication by the Commission of notice of its intention to initiate such proceeding nor later than 5 months after the expiration of such 60-day period. In any proceeding under this section, the burden of proof to show that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory or preferential shall be upon the Commission or the complainant. At the conclusion of any proceeding under this section in which a refund effective date has been established, the Commission shall order the public utility to make refunds of any amounts paid, for the period subsequent to the refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force, unless the Commission determines that such refund would adversely affect the public interest. The refunds shall be made, with interest, to those persons who have paid those rates or charges which are the subject of the proceeding. Provided, however, the Commission shall not order a refund of those revenues necessary to enable the public utility to obtain financing or to issue new securities and which must be retained by the public utility in order to meet its required coverage ratios applicable to the period between the establishment of the refund effective date and the date of the Commission's final order with respect to any such refund.

Further, the Commission is not authorized to establish a refund effective date nor order refunds with respect to any complaint or motion of the Commission addressing a rate schedule in the nature of an interconnection, power pooling, intra-system, joint electric facility ownership, or coordination agreement among affiliated or non-affiliated public utilities.

(c) Establishment of a refund effective date by the Commission in a proceeding filed pursuant to this section shall not preclude the filing of a subsequent complaint by the same party or any other party or by motion of the Commission against the same public utility during the period prior to the Commission's final order in the proceeding. However, no refund effective date shall be established and no refunds shall be ordered in any subsequent complaint proceeding instituted against the public utility during the pendency of the initial proceeding.

Section 3. FEES UNDER SECTION 205.

Section 205 of the Federal Power Act is amended by adding the following new subsection at the end thereof:

"(g) FILING FEES. -- The Commission shall not charge any fee in connection with any filing under this section proposing to decrease the amount of any rate or charge made, demanded or received by a public utility."

Senator **Bumpers**. I think that last point is well taken, Jerry, and I regret that we did not do that today, but we will get additional testimony either for a hearing or for the record because I think that a common feeling among all the investor-owned utilities is that this legislation will increase their costs of capital, costs of money.

I do not understand why, frankly, and I am not sure I agree with the utilities' views, but I am certainly willing to get some analysts in here and let them give us their views on it and their rationale as to why this legislation would or would not.

Senator **Ford**. Mr. Chairman, could we also have a State regulatory member at the next hearing, if we have a hearing.

Senator **Bumpers**. Sure.

Mr. Berlin.

STATEMENT OF EDWARD BERLIN, SWIDLER & BERLIN, ON BEHALF OF NEW ENGLAND POWER CO.

Mr. **Berlin**. Mr. Chairman, Senator Ford, thank you for this opportunity.

In my prefiled testimony, Mr. Chairman, I endorse without qualification the principles that utility rates should, to the greatest extent possible, reflect actual costs. I also believe that to the greatest extent possible the playing field should be a level one. Those are principles which I have advocated as an intervenor representative, as a utility representative and as a state utility regulator. And if I believed that the enactment of S. 1567 could further those principles and do so at a reasonable cost, I would be up here today championing its enactment.

But that is not my conclusion, Mr. Chairman. In the testimony that I have prefiled, I note that you, Mr. Chairman, have very correctly pointed out the major elements of costs that have the greatest impact on rates, and I begin my discussion by analyzing whether or not it is necessary to enact legislation in order to make certain that those particular significant cost determinants are accurately reflected in rates.

My conclusion is that it is not necessary that legislation be enacted for that purpose. Nevertheless, Mr. Chairman, I would still support the enactment of S. 1567 if I believed that to do so would be costless. That is not my conviction. Indeed, it is quite to the contrary.

We all know the financial crisis that the utility industry has just come through, is indeed in the midst, hopefully, of coming through. It is a crisis that we all have a stake in, be we utility advocates or consumers that are served by them. I will not endeavor to assign responsibility for that crisis. That is not germane to the issue before you.

But I will say to you that the crisis has shaken the confidence of the investment community, the investment community that must be looked to to provide the enormous amount of capital that this industry, like it or not, will require in the future as it confronts the necessity for additional capacity, and the future is not far away in too many parts of the country.

Because of that crisis, the investment community is now confronting risks that it never perceived before. We cannot be sanguine that because of that perception it will continue to make investment funds available at the reasonable prices that we have experienced, in the future.

I suggest to you that S. 1567 will exacerbate that difficulty. It will do so for the very reasons cited by Mr. Mundy, because you will put a cloud over the only security to which the investment community has been able to look with confidence in the past, the fact that revenues, once determined to be lawfully collected, will no longer be recaptured retroactively. That security will no longer pertain.

And I can tell you from my experience with the investment community that notwithstanding the events of several Mondays ago, they do respond rationally. They do look at risks. They evaluate risks. And they cost out those risks.

I do not know what cost they will assign to this new risk, but there will be a cost. And I suggest to you that we do want to know what that cost might be because it is a cost that will pertain to every dollar of utility investment in the future, whether or not a 206 proceeding is in fact pending against the utility, because the risk will always be there that such a proceeding could be initiated.

Let me ask that you consider the fact that several additional questions deserve to be answered before you proceed further. For example, how will coverage calculations be made in the future both under mortgage bond indentures and under covenants that restrict preferred stock? How will the utilities and the investment community make those coverage calculations if earnings are subject to recapture? How will the SEC react to the coverage calculations that are made by the utility industry? What are the accounting implications?

I will not be foolhardy to try to go into a discourse over the standards promulgated by the Financial Accounting Standards Board, but we must not assume that they will not have implications to this new risk, this new contingency that would be imposed on utilities.

I can tell you, Senator Ford, because I know from a very analogous situation that I was involved in in a 206 proceeding, that the enactment of this legislation will lead to qualified financial statements. I know that for a fact. What cost will that impose on utility investment if most utility or many utility financials are qualified as a result of this new exposure, this new risk?

I suggest to you, Mr. Chairman and Senator Ford, that these are questions that are worthy of being asked and worthy of being answered before you proceed with enactment of this legislation?

And let me also suggest one other series of questions that I would urge you to address to the municipal and cooperative systems. Are they willing to subject their revenues to retroactive recapture? Are they willing to go to the bond market, are they able to go to the bond market if their revenues were subject to recapture by an independent body? And if they did go to the bond market, what premium would they be required to pay? Indeed, I urge you to ask the municipal and cooperative systems, would they be willing to have you amend the Federal Power Act and S. 1567 to make their systems and their revenues fully subject to the same contingency that the investor-owned systems would be subject to were you to enact this legislation?

And I know what their answer will be. It is the only logical answer. Of course not, because if you do that you will put a cloud over our earnings, you will inhibit our ability to raise capital, and you certainly will deprive us of the ability to achieve the lowest cost capital; and they should therefore urge you not to subject them to the same responsibility and obligation.

No, I suggest to you that the consumers of the investor-owned systems deserve no less protection, and therefore I ask that you not single them out for this kind of discriminatory treatment.

Senator Ford, I would be doing a disservice to my client, New England Electric, if I did not tell you that over the course of the last year it filed before the FERC some $50 million in rate reductions, in part reflective of the Tax Reduction Act, and has just filed a rate decrease before the FERC without any compulsion of a 206 proceeding.

Thank you very much.

[The prepared statement of Mr. Berlin follows:]

STATEMENT OF EDWARD BERLIN
SWIDLER & BERLIN
on behalf of
NEW ENGLAND POWER COMPANY
on The Regulatory Fairness Act (S. 1567)
Before the Senate Committee on Energy and Natural Resources

Mr. Chairman and Members of the Committee, I appreciate the opportunity to provide you with my views, and those of New England Power Company, on S. 1567, "The Regulatory Fairness Act."

While my testimony will raise what I hope you will agree are serious questions that should be addressed before proceeding further, I am absolutely committed to the premise of the proposal -- that rates charged by electric utilities should reflect actual costs, no more and no less. It is a principle to which I have been committed throughout my career, as a representative of consumer and environmental intervenors, as a utility regulator, and as a utility advocate.

I am supportive, as well, of the principle that the "playing field" should be a level one. Much of my professional career has been dedicated precisely to making that a reality.

Surely no one can seriously dispute that if a legislative solution can further these objectives, and by so doing reap positive benefits for consumers, it deserves our unified, enthusiastic support.

But, I suggest, the enactment of S. 1567 will not achieve a level playing field and in its failed attempt to do so it is likely to subject the very consumers you seek to protect to a new level of potentially costly risk.

Presently, I will develop the analysis that led me to conclude that the enactment of S. 1567 will not further the "level playing field" objective and will suggest a number of minimum modifications to the proposal that could help to bring that goal closer to realization. But that is not the burden of my presentation. Rather, it is to suggest, most respectfully, that the hidden costs of the proposal before the Committee -- all of which will fall to consumers -- remain too high and that a great deal of what S. 1567 seeks to achieve for consumers can be accomplished today without the introduction of costly new risks.

As an aside, but I submit an important one, it is instructive to examine the items of cost subject to fluctuation that Senator Bumpers and Senator Chafee identified when S. 1567 was introduced. They referred to changing corporate tax rates, interest costs, fuel charges and the costs associated with new plant construction, as items that might lead to rate reductions for wholesale customers.

Unquestionably those are the appropriate components upon which to focus for their impact on costs -- and therefore on rates -- is most pronounced. But is it necessary to amend Section 206 of the Federal Power Act to ensure that consumers are benefitted when those costs are thought to have declined? I suggest not.

Fuel Charges. The problem cannot be with the cost of fuel for typically fuel charges are recovered through fuel adjustment clauses which track automatically actual costs -- be they increasing, as was the experience through much of the 1970's and early 1980's, or decreasing, as has been the more recent experience.

Taxes. Corporate tax rates can, as we know, change and thereby increase or decrease a utility's revenue requirement. But recent experience demonstrates that the FERC is committed to ensuring that consumers realize the benefits of tax decreases without delay. While the Commission's response to the 1986 tax reduction was to call for voluntary action on the part of the industry, I have not heard it suggested that the industry failed to be responsive. Moreover, we do not often experience significant tax changes, particularly decreases. In this one highly unusual circumstance, the Commission was on top of the situation. The system worked. No one is now contemplating further corporate tax decreases. In the case of NEP, the Company submitted revised rates to reflect not only the lower effective tax rate in the 1987 transition year, but also the lower corporate tax rate for 1988.

Construction Expenditures. A large construction project most assuredly can affect costs and rates but we must remember that until construction is complete consumers are shielded from a large portion of those costs. It is the utility that is anxious to have its rates reviewed as soon as is possible after it no longer is confronting major construction expenditures. (Significant perturbations in wage costs, referenced by Senator Bumpers, generally track construction activities.)

Cost of Capital. Finally, interest rates may decline but again the Commission has demonstrated its commitment and its ability to act expeditiously. On March 26, 1987, the Commission, precisely because it questioned, in light of declining interest rates, the continued appropriateness of the companies previously established returns on equity, instituted Section 206 proceedings against Yankee Atomic Electric Company, Vermont Yankee Nuclear Power Corporation, and Connecticut Yankee Nuclear Power Corporation. The Administrative Law Judges were directed to issue their decisions within four months and they did. Less than three months later, the Commission issued its decision. Section 206 can work and, as the Yankee cases demonstrate, can operate to make a rate reduction effective on a schedule that would be comparable to a rate increase.

I urge that you pause to reflect on these major determinants of rates; to consider whether a case has been made establishing the need for a legislative response. If you disagree with my negative conclusion it is nonetheless appropriate to ask whether there are risks and important questions that should be confronted before you proceed with S. 1567? I respectfully submit that there are.

The mere enactment of S. 1567 has the potential to affect adversely the consumers of every single FERC-regulated investor-owned electric utility whether or not a complaint is ever instituted under Section 206.

Since the enactment of the Federal Power Act in 1935, utility investors -- whether they be the individuals who invest in common equity (and utility equity largely is owned by individuals) or institutional investors (be they lending institutions or pension funds) that invest in debt -- have had the ability to look to a utility's stream of revenues and to its financial statements and make judgments about the risk associated with the investment.

While always recognizing that the FERC could, either on its own initiative or upon a complaint, reduce rates prospectively, there was never a danger that revenues collected pursuant to rates previously approved may have to be given back. It was possible, therefore, to make reasonable coverage projections and the result was to provide utilities, by and large at reasonable rates, with the capital they required to meet their service obligations. Those reasonable rates were accepted by investors because they considered it possible to measure the risk, and were directly reflected in lower costs to consumers. Any increases in financing costs will necessarily be reflected in increased costs to customers.

This Committee need not be told that the industry has confronted a crisis in recent years. Large construction projects have required unprecedented levels of capital and when construction was nearing completion investors were confronted with a reality never previously faced. Regulators began to deny recovery not only of a return on a portion of the invested capital, but they denied recovery of the investment itself.

Now is not the time to debate what gave rise to the recent crisis and, in truth, for present purposes it matters not how much of the blame lies with inflation, with changing regulatory requirements, or with the utilities themselves.

The reality is that the long-depended upon utility investor has been shaken. As a nation we will need new generation in the future. In many regions the future is now upon us. Can we be sanguine that investors will continue in the future to commit capital for necessary construction projects at reasonable rates? Is this the time to add a significant new risk? Is this the time to expose utilities to a largely unquantifiable refund obligation and to announce to potential investors that they no longer can remain confident that the stream of revenues and the level of retained earnings to which they have always looked for security, no longer can be considered secure? Will the required capital still be available? At what price?

Unless we assume that investors act irrationally we must recognize that the enactment of S. 1567 would introduce a significant new risk for a capital intensive industry. Investors will respond as they do to all risks -- if they are willing to make capital available at all, they will demand a higher return.

And the higher return will be demanded whether or not the remedy made available by S. 1567 is ever invoked. It is enough that it may be.

Are we sanguine that we know what the added cost to customers will be? Will it be 50 basis points? 100? Whatever the level, what will the total price tag be on the enormous level of capital that must be attracted each year? Can we be confident that it is a price worth paying?

Do we understand the accounting implications of S. 1567? At the moment the accounting community and the utility industry are struggling with difficult questions under new guidelines of the Financial Accounting Standards Board relating to the evaluation of certain rate regulatory contingencies for financial reporting purposes. Many utilities are at present confronting the possibility of large writeoffs.

Do we know how the Financial Accounting Standards Board may respond to the enactment of S. 1567? I can tell you that the range of refund exposure that would have had to be assumed in the recently completed Yankee cases, if S. 1567 were the law, would have been sufficient to require qualification of the financial statements. What are the implications of qualified financials? What might be the possible cost consequences? Is it worth incurring that cost?

How will the enactment of S. 1567 affect coverage calculations under existing indenture agreements? How will the Securities and Exchange Commission view the coverage calculation of a utility threatened with an unquantifiable refund exposure? How will any utility be able confidently to conclude that it does not face that exposure whether or not a Section 206 proceeding has yet to be initiated?

It may be quite instructive for you to pose these questions to the municipal and cooperative systems that are urging enactment of S. 1567.

Are the municipal power systems willing to subject their revenues to unlimited downward retroactive adjustment?

If a municipal power system could never provide assurance to the purchasers of its bonds that revenues already received are immune from recapture by the action of an independent body, would the bonds be marketable? At what price?

Are municipal and cooperatively-owned power systems willing to subject themselves to the same regulatory exposure which investor-owned utilities would confront under S. 1567?

I dare say they would not and for good reason. It would threaten their ability to continue to assure their consumers adequate supplies of power at the lowest reasonable cost.

I sympathize with that objection but I am equally desirous of insulating *all* consumers from unnecessary supply difficulties and cost increases.

At the outset I suggested that S. 1567, if enacted, would not level the "playing field." To explain how I reached that conclusion it is necessary that we first appreciate the realities that confront utilities that seek increases pursuant to Section 205.

Section 205 does not provide a utility with an immediate opportunity to recover increased costs. The filing requirements are complex and require the development of a voluminous body of financial, accounting, engineering and planning (e.g. load growth estimates) information supported by sworn testimony which is subject to cross-examination. Typically the information must be prepared for two discrete time periods: an historical twelve-month period and the prospective twelve-month period for which rates are being established. The lead-time required is not insignificant, and all of that precedes the sixty-day notice period and up to a five month additional suspension period. Realistically, the process can take up to a year and the rates that then go into effect are subject to refund together with interest compounded at the prime rate.

Further, the so-called "filed rate" doctrine applies meaning that whatever the facts established during the proceeding, the utility cannot be authorized a revenue level in excess of that for which it filed. Accordingly, the moment the rate filing is submitted, everyone can estimate the precise range of dollars that are in issue.

Finally, the Commission makes its judgment as to the appropriate rate level based on predictions offered by the utility, the Commission staff and intervenors. And if the Commission's judgment turns out to be in error, that is if actual costs greatly exceed what the Commission estimated when determining the increase that it would allow, there is no opportunity for reparations. There is no opportunity for the utility to be made "whole".

Contrast the realities of Section 205 with the circumstance that would pertain under Section 206 if S. 1567 were enacted.

- there would be no requirement that a complainant file information, let alone sworn evidence, detailing the bases of its contentions that rates are excessive;
- there would be no requirement that the complainant, or the Commission when initiating a proceeding, quantify the dollars at issue as to each alleged impropriety;
- there would be no test-period requirement, either historic, contemporaneous or projected;
- there would be absolutely no ability for the utility or its wholesale customers to estimate accurately the dollars that may be in jeopardy because of the absence of any requirement for specificity, the absence of any refund floor, and the ability of the Commission to redetermine prior rates with the benefit of hindsight; and
- while the Commission would continue to lack authority to rectify, through reparations, a revenue deficiency, it would be required to recapture any overestimates.

The consequence, I submit, would not be to level the "playing field" at all; to the contrary the tilt against utilities would be exacerbated and in the end it is their customers who will suffer.

I hope that you will agree, therefore, that it is inappropriate to enact S. 1567 into law and thereby upset the delicate balance that has served the nation well for over 50 years, through periods of decreasing costs as well as increasing costs. Indeed, to the extent that there is a problem, it is one that largely can be rectified by the Commission itself without new legislation. Apart from the initiatives it already has taken, there undoubtedly is more that the Commission can do to expedite the rate setting process. It is not the case that utilities place a premium on delay. To the contrary, the long-lived revenue uncertainty coupled with compounding refund obligations, provide powerful incentives to move forward expeditiously. The Commission has taken steps toward expedition. That is the effort that deserves priority.

Recognizing that notwithstanding my convictions you may be encouraged to proceed with legislation, I urge that you recognize the necessity for modifications to S. 1567 both to minimize prejudice which has the potential to be quite costly, and to move closer to the realization of a more level playing field:

- require the complainant to submit rigorous data analogous to that which must, under the Commission's regulations, accompany rate increase filings, including specificity as to the costs at issue and dollar estimates of any claimed overcollections;
- make it explicit that if the record developed before the Commission justifies a retroactive upward adjustment in rates, that the Commission will be authorized and obliged to permit the utility to recover any deficiency through an appropriate surcharge;
- require that the Commission, when initiating a proceeding under Section 206, establish, based on a reasoned explanation, a minimum revenue or rate floor below which refunds may not be ordered; and
- require that the Commission give priority to Section 206 proceedings and that it expedite such proceedings to the greatest extent possible consistent with due process.

Mr. Chairman, S. 1567 focuses on issues which are of critical importance to the electric utility industry, its investors and ratepayers. I appreciate the opportunity to share with you my experience as it bears on your deliberations.

Thank you.

Senator **Ford**. So that makes two.

I am getting some action here now, Mr. Chairman. Maybe we do not need this legislation.

Mr. **Mundy**. Well, I want to tell you this, that I have four clients that filed any number of rate decreases, and they did so voluntarily. And I have also got the same clients that came in through the coersion of the FERC staff who said if you do not do it, we are going to do something to you, and we thought the better part of valor was to go on and have a rate decrease.

To say that FERC does not have adequate power now and a big sledge hammer on the public utilities' heads is just wrong.

Senator **Ford**. They are not as benevolent as Congressman Bruce would have you believe.

Mr. Chairman, would it be in order that if you do have another hearing on this particular piece of legislation, that if not a witness, then would it be possible to secure a statement from the SEC before the next hearing based upon Mr. Berlin's statement.

Senator **Bumpers**. I think it probably would be.

We are not rushing to judgment on this thing, and I want to make sure that everybody feels that just because I am hot for this bill does not mean that I do not want to be fair about it. I mean, we are going to listen.

Senator **Ford**. Well, you have always been fair.

Senator **Bumpers**. Jerry, let me ask you this question.

Why, if it is, if we are going to exempt power pool sales or system agreements, which Middle South has a lot of, from this bill, why should we amend current law on rate increases to exempt power pooling too?

In other words, if we are going to exempt system agreements and power pooling from this application under 206, why should we not also do the same thing on 205?

Mr. **Jackson**. Mr. Chairman, I think it deals with the basic distinction between the type of transactions that are involved in the power pooling transaction and one that involves some more traditional, what I will call a traditional wholesale sale being one between Arkansas Power and Light Co., for example, and the city of North Little Rock. There you have a more traditional customer versus utility situation.

In the power pooling transactions, the transactions involve in large measure essentially simultaneous sales and purchases between two separate utility companies. In a number of the pooling agreements they may provide for a rate that is applicable to both a sale and a purchase. Obviously that in itself creates some assurance that the rate will be correct and that companies are agreeing to not only make sales but purchases under the same transactions.

Again you are dealing in large measure with power pooling questions and questions not of a return to shareholder but more an allocation of cost among a pool to the correct entities that should bear those costs.

It is just entirely a different transaction than your traditional transaction where you might find the members of the APPA and co-ops might be involved as customers there.

Senator **Bumpers**. Mr. Mundy, let me turn to you and just ask you this because you mentioned risk.

And let me ask you, number one, if an applicant files for a rate reduction under 206, under existing law it may take a year, it may take three years to get a determination from FERC, but just for the sake of argument, let's say it takes three years. You have heard the stories here about how long it takes, and I think the figures, when they come in, will show that a rate reduction application before FERC takes twice as long to resolve as a rate increase does, and I think the reason is precisely what I said earlier, and that is the power and the resources are with the IOU in that case, and it is to their advantage to drag it out, knowing that there will be no retroactive application if a reduction is granted.

Now, I used to practice law, and if I were an attorney for a utility against whom an application for a rate reduction had been filed, I would drag it out as long as I possibly could, knowing that even if I knew in my heart and the statistics were irrefutable that they were entitled to this reduction, I would still drag it out knowing that they were not going to get a dime until the final decision was made; whereas if you were applying for a rate increase, you are going to get it between 60 days and 7 months after filing, if you are entitled to it.

Now, let me ask you first of all, why is that not just—we all have a definition of fairness. Why is it fair for utilities to ask for a rate increase and get that increase retroactively, no matter how long it takes for FERC to act on it. If it takes FERC two years, the most the the utility is going to lose is back to about 60 days from the time they filed their application. But if they file for a decrease, the consumer is not going to get a dime until the day the decision is made, and that may be three years later.

Why is that fair?

Mr. MUNDY. Well, Senator, there was a lot in the introduction there that I will not want to plead guilty to because I am not a very good lawyer, I guess, because we have not done that for my clients. I have not procrastinated and I have not tried to beat them out of too much money. But certainly utilities, you know, it is not its job to look out for the public interest, and it is not its job to make sure every customer is doing the most wonderful things, and we are not people with halos around our heads. I am not going to even imply that to you.

But FERC is there to do that, and I submit to you they are doing it. And that is one reason I do not think the legislation is needed.

Let's look at the rate decrease——

Senator BUMPERS. No, what are you saying is one of the reasons? I do not understand what that reason is.

Mr. MUNDY. That legislation is not needed to make FERC to go ahead and decide these cases and decide them quickly.

Let's look at what the recent——

Senator BUMPERS. Now, let me just take issue with you there, Mr. Mundy. We are not trying, we are not trying to make them expedite these cases.

Mr. MUNDY. Why are you not?

Senator BUMPERS. I think that will be the result.

Mr. MUNDY. We should be, though.

Senator BUMPERS. But we are not trying to make them. We are simply saying you take all the time you want, but if you rule that a reduction is in order, then it is effective from a date set 60 days to 7 months after the application is filed.

Mr. **Mundy**. Well, let's look at the record. I think I have got to stand by it because, you know, we talked about the 600 days and the 300 days, and I say both of them are highly misleading, and I do not have all the figures, but I do know what has happened lately. In four instances there have been complaints filed recently that I know about to ask for a rate reduction, and those were the Yankee cases, and I think Mr. Berlin was involved in some of those. And it was almost precisely 6 months from the time FERC undertook those cases to its final decision in those cases. That is less time than it takes a utility to file for and get a rate increase and get a rate increase subject to refund.

It can be done if you have a valid complaint, and we are talking about a rate decrease. FERC has got the wherewithal to undertake and do these transactions and make utilities reduce their rates. They have got all kinds of power over us; I will assure you they do.

And I will submit to you they have done it by several methods.

Senator **Bumpers**. But what if they do not do it?

You are suggesting that FERC is perfect and that they know every rate reduction that should be ordered and will do that.

Mr. **Mundy**. No, sir. They are not perfect, and I would not want to say that. But I do believe that when a situation is brought to their attention, they have moved extremely fast and ordered the rate reduction for a utility. For instance, it takes us 6 months to prepare a rate decrease—I mean a rate increase under section 205 before we can even file it to meet all their regulations. That is not true under section 206.

There is an additional 6 months over on the 205, and we are not taking that into consideration here because it takes that long to put all the data together to file for the rate increase. As far as I know, they have been acting swiftly on rate decrease applications, the FERC has. I do not know when they have not been.

Senator **Bumpers**. Well, Mr. Mundy, the indications are that it takes them twice as long to rule on a decrease as it does on an increase.

Mr. **Mundy**. Well, I do not think that is right. I think you will find that in section 206 proceedings, those involve section 206 proceedings like the Pacific intertie, which did not involve rates but complications allocations of that intertie to the Northwest and the cheap hydro power where everybody—Lord knows, if they ever get that straightened out, it would be a miracle. And that would go into those figures. But, I mean, that has been going on for 10 years. That skews those figures for section 206 complaints completely—it does not have anything to do with this legislation.

Senator **Bumpers**. Mr. Berlin, let me turn to you for just a moment.

Bear in mind that this bill does nothing to affect just and reasonable rates. This does not give the investor-owned utilities an up or a down. The just and reasonable rate rule is not affected. What we are saying is that if the rate is excessive and it is found by FERC to be excessive, then the complainant will have a right to a refund effective the same date and under the same circumstances that

that utility is entitled to an increase if it is found in separate cases that they are entitled to one.

Why is that not fair?

Mr. **Berlin**. I understand that, Mr. Chairman, and it is a compelling point, but let me put that in perspective for you.

Certainly we all want the Commission to set in every case just and reasonable rates, whether we be intervenor advocates or utility advocates. But consider how rates are set as the Commission strives to set just and reasonable rates.

Currently, when the Commission is adjudicating a 205 case, it sets its rates based upon estimates, not with the benefit of hindsight. It sets rates based upon estimates that it thinks will be just and reasonable. Sometimes those estimates result in excess collections. Sometimes those estimates result in collections lower than are in fact required, with the benefit of hindsight, to obtain just and reasonable rates.

Those are the rules of the game by which everybody plays. Those are the rules that have been accepted by the investment community. But now what you are saying in this legislation is that, well, wait a second. When, with the benefit of hindsight, it becomes possible that the result of the estimation process may have erred on the high side, we will allow all of that excess to be recaptured, even though there is no way that a utility can ever be made whole when the estimate turned out to be on the low side.

And I suggest to you that that is not a level playing field, and suggests a rather dramatic departure in the way risks are currently evaluated.

Let me just say in response to add one thing in response to Mr. Mundy's question because all of my utility clients do happen to wear halos. And I was counsel in the Yankee cases, in two of the Yankee cases.

Those cases were 206 cases, and they were over, a final decision was issued in less than 7 months.

Now, let's contrast that, Mr. Chairman, with the situation that confronts a utility when it believes that its costs are going up and therefore its rates should be adjusted upward. Mr. Mundy is correct, it takes a minimum of 5 to 6 months to put the filing requirements together, and then you submit it to the Commission, and the Commission suspends it not for 60 days notice plus one day, but for 60 days plus 5 months, which means you have no hope, realistically, of being able to reflect increases that have occurred in rates for a minimum of 1 year when you combine the preparation period that is onerous with the suspension period that is a reality.

Senator **Bumpers**. Well, now, Mr. Berlin, I have seen, at least before the state public utility commissions, I have seen a lot of amendments in applications during the hearings when unusual circumstances arise over the course of a 6-month to 1-year hearing, I have seen utility companies alter their application, amend their application during the process of the hearing, have you not?

Mr. **Berlin**. In the case of the FERC, a utility is limited to the rate level for which it files. It cannot, no matter what the hearing develops, receive revenues in excess of the rate level.

If during the course of the pendency of the rate proceeding, and assuming, by the way, that the suspension period is over, because you cannot, without the Commission's permission, piggyback rate filings.

Senator FORD. We call it pancaking.

Mr. BERLIN. Pancaking, that is correct.

If you filed a new rate increase filing in order to take account of those changed circumstances——

Senator FORD. It takes a separate hearing?

Mr. BERLIN. You would be subject to a new suspension period.

Senator BUMPERS. You would be permitted to put on testimony, would you, if some inordinate cost had affected you adversely?

Mr. BERLIN. No, as a matter of fact, there is a lot of resistance to the so-called moving target. You are stuck largely with what you filed, both the level and the rationale.

Senator BUMPERS. Does that work both ways, too? If somebody filed a complaint under a 206 and your costs were going down, would they also be locked into their original complaint?

Mr. BERLIN. Not as I read this legislation, Mr. Chairman.

Senator BUMPERS. Well, do you think they should be?

Mr. BERLIN. I think as a minimum, in order to establish some range of certainty, you would certainly want to require that there be specificity, specificity not only as to the issues in dispute but as to the dollars associated with each of those issues.

Senator BUMPERS. What is there in this language that causes you to think that would not apply in a 206 application just as it does in 205?

Mr. BERLIN. It simply is not the history of 206.

Senator FORD. There is a floor the House would not put in that left it wide open.

Senator BUMPERS. Did the House not amend the bill to take care of that?

Senator FORD. No, sir.

Mr. BERLIN. The House did amend the bill to take care of some specificity in the complaint, but it did not require any specificity as to the amount of dollars at issue nor a limit on the amount of dollars at issue.

Senator BUMPERS. Do you agree, Jerry, with the Robert Bork decision on the Jersey Central case, where he said the overriding concern is always the health of the utility company?

Mr. JACKSON. Mr. Chairman, I do not know that that should be the overriding concern in all cases. I do think, in answer to a question you raised earlier on today, that the FERC must look at the financial health of the utility as well as the consumers' interest in a rate proceeding. I think that is true for all regulatory bodies, State or Federal. A balance has to be struck, obviously, by the regulatory agency.

Senator BUMPERS. Well, in the Grand Gulf case, of course, those of us who disagreed with the decision felt they had gone too far. To say that you had to reach a rate that would save a company is one thing, no matter how imprudent they might have been. And to say that they are entitled to an investment return on what might be considered a highly imprudent decision is a very different thing.

Those balances are always very difficult to work out, and of course, one of the major issues in the Grand Gulf case is how you work out the problems the consumer has with the tremendous debt that Middle South had incurred.

Mr. JACKSON. I would like to make two points, Mr. Chairman. First of all, we are not putting a limit in any of these amendments that we are discussing on what the FERC might determine to be in the nature of a just and reasonable rate that would operate prospectively. It primarily deals to what extent during the regulatory proceedings period, however long that takes, what is the cloud that is hanging over the rates that are being collected during that period of time.

And it is our position that since, in a 206 proceeding, you are dealing with a rate that has been found to be just and reasonable, or allowed to become effective by the FERC, then that rate should stay in place until there has been a different determination.

And we are not talking about putting a floor on what the FERC might do thereafter. We are only talking about that amount that would be subject to refund during that period of time.

One other point that I ought to make, Mr. Chairman, since we have discussed Grand Gulf, because we have all talked about experiences with 206 that might be different than the 600 day discussion that we have had in the hearing so far. I might point out that the only 206 case that I am familiar with involving the Middle South Utility System over many years involved the Grand Gulf case. The Louisiana Public Service Commission filed a complaint in September of 1986 dealing with the rate of return on equity for Grand Gulf. I might point out that is the only issue that really is relevant to a 206, 205 type discussion in that Grand Gulf is a formula rate. When there are changes in interest costs, when there are changes in tax laws, those are automatically reflected.

So this discussion really is not extremely relevant to that type situation. But just as an example, on the return on equity question which is fixed in that rate schedule, the LPSC filed their complaint in September. We filed our answer to that complaint in November. There were negotiations that took place immediately. The FERC did emphasize an expedited procedure for that case; a settlement reached in May, and in September the FERC approved that settlement that was retroactive to July 1, 1987. So you had a period of time from September to July in which that 206 proceeding took place.

And that is the only 206 proceeding that has affected any of the companies of the Middle South System, at least in my 10 year history.

Senator BUMPERS. Was there any retroactivity agreed to?

Mr. JACKSON. Retroactive to July 1. It was approved September 15.

Again, the process began with a complaint in September of 1986. The rate change became effective in July of 1987.

Senator BUMPERS. So there was about 10 months there, and there was no——

Mr. JACKSON. No retroactive.

Senator BUMPERS. No retroactivity.

Mr. JACKSON. That is correct.

Senator BUMPERS. Jerry, are there any states that you know of that allow this differentiation between rate increases?

Mr. JACKSON. I was thinking about that. Obviously I am most familiar with Arkansas, but I would hazard a guess, based upon the Arkansas situation, which I do not think is too different from most states in general, that your bonding arrangements normally deal with rate increases, that the traditional law would be that if there is any rate reduction, that that would operate prospectively and not retroactively, and Mr. Berlin or Mr. Mundy might be able to supplement that.

Mr. BERLIN. My recollection from the New York situation where I had some involvement is that it parallels the Federal Power Act as it currently reads.

Senator BUMPERS. Mr. O'Neil, can you comment on that?

Mr. O'NEIL. As far as the state procedures, I am not aware of whether they are retroactive or not, Senator Bumpers if I understood the question correctly.

Senator BUMPERS. Well, I am asking. Do states allow retroactivity in cases of increases and no retroactivity in cases of decreases? Is that a state rule as well as a FERC rule?

It is in Arkansas, Jerry?

Mr. JACKSON. It is, Mr. Chairman. I think that is traditional among state and Federal regulatory statutes.

Senator BUMPERS. Is that the reason you fellows are fighting this so hard, you do not want this to become contagious?

Mr. MUNDY. Well, for balance, I have to say that is not the case in Alabama, Mr. Chairman. There you would have in either situation a rate decrease or an increase. The committee has to make a decision within approximately 6 months, and there is no provision for a refund either way.

Senator BUMPERS. Where is that?

Mr. MUNDY. In Alabama, which I would not suggest that that is the best situation.

Senator BUMPERS. Well, that may be the pervasive rule.

Mr. Moore, you sort of alluded to this in your testimony.

Can you comment on this?

Mr. MOORE. Yes. Obviously it varies by state. Many states that will allow a temporary increase will only do so if the utility can prove that they have a financial need. The FERC procedure or the Federal Power Act does not have any financial need requirement. A utility files an increase, they get it after the end of the suspension period. So certainly there are very few states that have an automatic increase such as in the act, and that was one of the things, actually, that we at NASUCA are concerned with, is the whole concept of the rate increase that is allowed as for whether or not there are possibilities of retroactive decrease, increase. It depends on states, but very few that I am aware of would have this kind of a procedure.

Now, others, I have seen commissions do some fairly innovative things. With the new Tax Reform Act, the State of Pennsylvania, effective January 1, 1987, declared every single utility rate temporary. It just announced, we consider all your rates are now temporary, we are going to investigate them. And once we figure out what your tax savings is, we are going to refund it back to January 1, 1987.

Obviously there is nothing in their act that specifically says they can do that, but they found it. And I would guess there are lots of other ways that commissions have been able to read their act to give them some sort of retroactive authority.

Senator **Bumpers**. Senator Ford.

Senator **Ford**. Mr. Chairman, we have kept these gentlemen long enough.

I have several questions in writing, particularly from the testimony that Mr. Mundy gave. In reading your testimony, I have about four questions for you, Mr. Mundy.

Having been governor, like Senator Bumpers, we understand those public services commissions and made those appointments. The Kentucky commission generally does not give a refund or an increase until the commission rules, and upon the ruling, then you get your decrease or your increase at that time. That seems to me about as good as you can do.

Mr. Berlin, let me ask you a question that has been bothering me for some time.

We are getting ready to enter into an accord with Canada. Also we are getting ready to sign a trade agreement with Canada, and we are going to import electricity.

Do you represent in your New England area New Hampshire or Vermont?

Mr. **Berlin**. I do represent a very large group of utilities in New England that have entered into a transaction with Hydro Quebec to import a fairly large block of capacity and energy.

Senator **Ford**. That is a long-term contract.

Mr. **Berlin**. Yes, it is.

Senator **Ford**. For New Hampshire and Vermont, 25, 30 years?

Mr. **Berlin**. No. The one that I am involved in involves utilities in all six New England States.

Senator **Ford**. All six of them.

Mr. **Berlin**. And it includes not only the investor-owned systems but the municipal systems as well.

Senator **Ford**. I got some of that information some months ago, and it appeared in I think "Energy Daily" that New Hampshire and Vermont as an entity had signed long term contracts.

Mr. **Berlin**. I believe that is true of Vermont. I am not sure that it is true of New Hampshire.

Senator **Ford**. Now, how would that work—I am just grasping. It has been some time ago, and I just happened to think about it when you were talking, and New England struck a chord with me.

How do we handle rate reduction for imports from another countrY? Do we do it the same way? How do we handle that under 206? How do you handle it under 205?

Mr. **Berlin**. Well, I think it would be a nightmare under 206. Under 205, I can tell you that the contracts that give rise to the importation from Hydro Quebec have all been filed and are presently pending with the FERC. So the FERC will have to exercise its regulatory jurisdiction with respect to those contracts, as it did several years ago with respect to the first phase of that importation.

Senator **Ford**. Now, I have a little special interest in mind as it relates to the ability to generate electricity in this country. But I think maybe we might be running into a bump. You said it would be a nightmare under 206.

Did I understand you right?

Mr. BERLIN. That is correct, and the reason for that is much the same as was discussed by Mr. Jackson, because essentially when you are dealing with allocation questions and when you subsequently reallocate, there is no way to undo what has happened in the past and thereby to make the parties whole.

Senator FORD. Are you familiar with the energy section of the agreement between the United States and Canada?

Mr. BERLIN. As it relates to——

Senator FORD. Energy imports.

Mr. BERLIN. As it relates to energy imports, I am.

Senator FORD. You are familiar with it.

Mr. BERLIN. In a general sense, yes.

Senator FORD. In a general sense you are.

Does it appear to you as a good or a bad agreement, as it relates to utilities and the consumer?

Mr. BERLIN. I think that the arrangement that has been negotiated on behalf of the New England utilities strikes a very appropriate balance for the consumers in New England.

Senator FORD. Well, but you are not alluding, then, to the agreement between the two countries.

Mr. BERLIN. That is correct.

Senator FORD. You are keeping that at arms length. Otherwise, you are saying that under the present circumstances, without an agreement, things are trotting along very well, and——

Mr. BERLIN. To this point they have been, sir.

Senator FORD. To this point they have been.

Well, we have got a typical agreement for the United States. We got our buns kicked, and we think it is a damned good agreement.

So that is the way I feel. We lost five to one, and still it was an agreement that this country wants to beat its chest about.

I thank you, Mr. Berlin. You are very effective, and I kind of like your attitude. I would not like to be against you in a court. I would not even put you up against Senator Bumpers. That would be too easy. [Laughter.]

Senator FORD. Thank you, Mr. Chairman.

Senator BUMPERS. Thank you, Senator Ford.

Mr. Berlin, let me ask you this. When somebody files for a rate reduction before FERC, does the ordinary investor-owned utility not know almost immediately whether that complaint has validity or not?

Mr. BERLIN. We know how we perceive the validity. We have no way of anticipating how——

Senator BUMPERS. I know you probably proceed on the assumption that it is not, but I am talking about in your heart of hearts——

Mr. BERLIN. Well, no, I can tell you not simply from my heart of hearts but from other parts of my anatomy that in the Yankee cases where there was very active and very serious participation by the Commission staff and by intervenors, including Mr. Scully and others around this table, that there were very dramatically differing views about what the appropriate rate of return should be. It varied all over the lot.

And quite frankly, if I were called upon to give an opinion letters, as unfortunately too often I am with respect to a utility's financials, I could not possibly gauge what the level of exposure might be.

So we do have a crucible that has tested that out, and that crucible suggests that there would be a great deal of very serious uncertainty, not frivolous at all.

Senator Bumpers. I must say, I am troubled by what seemed to me like a fairly straightforward, equitable proposition, that all of a sudden we have got all of these proposals of amendments and so on. I think there may be some validity to the proposition that it could conceivably raise the cost of money to utilities ever so slightly.

Mr. Scully, do you have any knowledge on that? Do you have any thoughts on it? Had you thought about it?

Mr. Scully. I have thought about it a little bit. As Mr. Berlin pointed out, I was involved in the Yankee cases, and I have been involved in other 206 proceedings, and in the Yankee cases, a number of very articulate attorneys put forth the same arguments that are being put forth here today, that the utility's financial position would be put in jeopardy. The FERC commission had all those arguments in front of it, and they dismissed those arguments. They came to the conclusion after studying the issue very carefully that the financial jeopardy of the utilities, or the financial position of the utilities would not be put in jeopardy by having something like an equity reopener.

Senator Ford. Mr. Scully, could I ask you a question at that point?

That is FERC's decision, but what about SEC? What about the banks that put the bonds together when you have to file a qualified financial statement?

Mr. Scully. I was involved in the testimony in the proceeding——

Senator Ford. I know, but FERC makes the decision. They are not the ones that are going to loan the money.

Mr. Scully. But FERC had expert testimony from the financial community.

Senator Ford. And that expert testimony said we could go ahead and let these investor-owned utilities have money based upon a qualified financial statement?

Mr. Scully. FERC did not agree with the utilities' position.

Senator Ford. But the financial experts said that the SEC would approve the bonds and approve the stock or issue new stock with qualified financial statements?

Mr. Scully. There are a number of financial qualifications that you will find in almost every utility's financial statements, and that does not preclude them from going to the financial market.

Again, in this position, what you are talking about is having FERC establish a just and reasonable rate. It is a just and reasonable rate. That is what the consumers are looking for.

Senator Ford. I am with you on that. Nobody objects to that. But when you go retroactive and you have a bottomless pit and you can go back forever, these people have had income, they have made investments, and the investor-owned are going to be in real trouble. I do not want to jeopardize them, and I think without a floor, given it all retroactive. Maybe I am too prone to be parochial, but nothing happens until the Commission makes a judgment.

Mr. SCULLY. I understand your concern, Senator, and when we talk about retroactivity here, I would like to make the record clear that if a customer files a 206 proceeding to reduce rates, you are only talking about from when the FERC Commission accepts that filing, and they determine a retroactive rate. So the utility knows when it is going to have its revenue stream. There may be some question about whether they have to refund moneys. If the customer never files a 206 proceeding, this never becomes an issue.

So when we talk about bottomless pit, I do not agree that there is a bottomless pit. What you are talking about is when a customer files a 206 rate and the FERC Commission agrees to that date and sets it subject to refund.

Senator FORD. What do you do with that money that you may or may not have to refund? Do you put it into escrow, let it grow at interest? You do not reinvest it in any of your facilities? Do you pay dividends with it, etc.?

Mr. SCULLY. There is no difference. If a utility files for a rate increase under section 205 and they put that rate increase into effect, they are collecting those extra moneys right away from the customer. The customer is paying for it. If at the end of the ultimate decision of FERC, the FERC finds that the just and reasonable rate is exactly as the utility had it before the filing, what happens to all the money that the utilities have collected then? It is subject to refund to the customers.

Senator FORD. Well, in my State, when the commission rules, it can go into effect. You do not collect any money until the commission says you are eligible for it.

Mr. SCULLY. But you have the same basic problem.

Really, you are talking about putting symmetry into the regulation process. That is the bottom line.

Mr. Mundy said that it is not the job of the utilities to look after the public interest, it is the job of FERC. And what we are trying to do here is to give FERC some ammunition.

Senator BUMPERS. I think Mr. Mundy would like to retract that statement. [Laughter.]

Senator BUMPERS. Let me point out that when a rate increase is made retroactively and then prospectively, that is sort of a bottomless pit, too. FERC has made a few decisions I disagree with very strongly, but it was a bottomless pit that I had to live with. And everybody else had to, too. And as you point out, I think symmetry is in order.

Now, Jerry, let me just ask you this question, on this question of financing. When you go to the market for money, you show them a certain return. You show them you are making a certain return, here are your rates in various States, and that is what it is producing. You give them a pro forma financial statement, this is what you expect in the future, plus the regulatory climate in the States and all the information they have to have, I guess.

Mr. JACKSON. That is correct.

Senator **Bumpers**. But, No. 1, every State, so far as I know, as well as FERC, says that you are entitled to just and reasonable rates.

Now, the Arkansas law provides that you will furnish them at the lowest possible rate, and I think that is not unusual. I think most States probably have a law similar to that.

Is it a fair statement, Mr. Berlin, or not?

Mr. **Berlin**. I think just and reasonable rate normally contemplates the lowest reasonable rate consistent with that.

Senator **Bumpers**. I am just sort of revealing the kind of questions I would like to ask someone from SEC or Wall Street about this.

No. 1, we are not talking about what kind of rate you are going to get in Illinois or Arkansas or Mississippi. We are talking about the kind of rate you are going to get from FERC because we are talking here about these procedures under FERC. And FERC says you are entitled to just and reasonable rates.

No. 2, they will normally provide for a 14 to 16 percent return on that, is that not correct?

Mr. **Jackson**. It is currently 14 percent on our system.

Senator **Bumpers**. I think they first said 16, did they not?

Mr. **Jackson**. They gave us 16 in 1985, that is correct.

Senator **Bumpers**. Now, if that is just and reasonable, then if you know that your power charges, we will say to North Little Rock, are providing you a return greater than that, and North Little Rock files for a rate reduction because you are getting a 20 percent return on your sale to them, you know immediately that you have got a problem.

Mr. **Jackson**. The problem that we have in the North Little Rock situation, and quite honestly in the whole Middle South Utility System would not be a great problem, but let me give you an example that we are concerned with, and again, it deals with the intersystem transactions and the power pooling.

The concern we have on our system, Arkansas Power and Light Co., is a long company and is selling capacity to the short companies on the system, principally out of the White Bluff coal-fired plant, and those are a significant amount of revenues that are being received by the Arkansas Power and Light Co. If a proceeding is filed that places a cloud on these revenues, then when AP&L tries to issue securities, it has to go to its underwriter or whoever and show its stream of revenues that can be counted upon to support that financing.

Normally, again, you look at your coverage ratios, do you have revenues sufficient to support your coverages.

The question becomes, if you are filing for a rate increase, you know; the amount you are collecting subject to refund you can discount. You know what the base is, the last rate approved by the FERC, for example. The problem on a 206 proceeding is that you may not know. It could be—you start getting into speculation, what will the FERC come out with.

And that I think is what we were trying to say. There needs to be some floor, some ceiling, whatever you want to call, something that gives you some certainty as to what is going to be the net result of this process because under a 205 situation you at least have what you have been collecting pursuant to the last order of the FERC. Now you have got a new cloud, and you really are not able to quantify that cloud. And it creates a lot of problems for the lawyers and accountants. That problem becomes financial risk, and financial risk translates to higher interest costs.

And that is why we are concerned, why we feel like there is a need for a ceiling.

I will agree that whether it is 16 percent or 14 percent AP&L and North Little Rock is not as significant a problem. The bigger problem is when you get into the bigger intersystem transactions and the millions and hundreds of millions of dollars that flow in that area. That is our basis for concern.

Mr. Chairman, I would like to make one point.

Senator BUMPERS. Sure.

Mr. JACKSON. We talked earlier about the comparison of FERC procedure and Arkansas Commission procedure. We are talking does the State commission allow a retroactive reduction in a 206 type proceeding? I said they do not. They follow a similar procedure.

After we discussed it we talked about—we did not talk about the standards for which you are allowed to put rates in subject to refund, and I should point out in Arkansas you can put rates in subject to refund when you file for an increase, but you do have to demonstrate an immediate and compelling necessity. I did not want to imply that the same standards for putting rates in subject to refund between the State and Federal would apply in Arkansas. I was dealing with whether the reduction is retroactive or not. But I wanted to be sure the record was clear on that.

Mr. BERLIN. Mr. Chairman, when I said that I thought most States follow the same situation that exists under the Federal Power Act, I meant with respect to the possibility of retroactive refunds under a 206 analogy. I was not addressing how rate increases are made effective. There is a variant between the Kentucky situation described by Senator Ford and what exists under 205.

But I know of no situation where it is possible to recapture revenues that were collected pursuant to previously approved rates.

Mr. JACKSON. That is a point I wanted to make as well, Mr. Chairman, but not imply that the same bonding procedures are available between FERC and the State.

Senator BUMPERS. Say that again, Mr. Berlin. I did not quite understand that.

Mr. BERLIN. I do not know of any State situation that in effect would allow what S. 1567, if enacted, would allow the FERC to do.

Senator BUMPERS. You know of none?

Mr. BERLIN. I know of none.

Mr. JACKSON. That is consistent with my understanding, too, Mr. Chairman.

Mr. MOORE. Mr. Chairman, as I told you, commissions have interpreted their acts to allow them to do just that, where they have issued an order ordering that the rates will be subject to refund after they have had analysis of utility earnings. They did it, as I said, in Pennsylvania by determining all rates to be temporary, and in Illinois they simply ordered each utility to account for the tax savings and set it aside, and that amount would be subject to refund, even though the rates were being collected subject to a commission approved order. And Illinois is not unusual in that way.

I think many States use this refund account mechanism. So there were utilities across this country collecting rates that were approved by those States that are subject to refund after investigations are completed on tax reform savings.

Mr. KANNER. Mr. Chairman, I might add that the Iowa Commission has a similar provision for rate reductions where there is a refund provision. I would note, however, that in that situation the CUB, the Consumer Utility Board, does file what would be equivalent to what the investor-owned utilities are referring to as a floor, but there is in that situation, once the final determination of a just and reasonable rate is set, that it does have both a refund provision as well as prospective rate relief.

Senator BUMPERS. Well, we could carry this thing on all afternoon. I have some other questions. But I will, in the interests of time and in deference to your time, we would submit the questions for each of you.

I am advised by Republican staff that Republican members will also be submitting questions to you, and I am not going to put a deadline on you, but if you can get those answers in as soon as possible, it would really expedite this hearing.

Did you want to say something?

Mr. MUNDY. Just, Senator Bumpers, could I be so bold as to say one thing, and that is that EEI would support the hearings with a submission of testimony on the financial and accounting issues that we talked about earlier, and further, and one other thing I did not discuss, and that is in my testimony I referred to an accounting opinion that EEI has requested on the effect of the Senate bill 1567, and that is not quite ready yet, and we would like to submit that as a late-filed exhibit, if we could, and if we could have 30 days or so to do that, we would most appreciate it.

Senator BUMPERS. That will be granted, and we would be glad to receive it.

Mr. Mundy, I was reluctant to bring this up, but we had been advised that EEI supported this bill, so I was a little surprised by your testimony today.

Mr. MUNDY. Well, I get confused about these legislative things sometimes too, Senator Bumpers. But I think——

Senator BUMPERS. Has there been a change in EEI's position?

Mr. MUNDY. No, sir, I do not think so. I think what EEI agreed to on the House side—and I was not there, so if somebody disputes this——

Senator BUMPERS. So you have muddied the water?

Mr. MUNDY. I hope not, but they agreed to not oppose the passage of the bill in the House after the amendments were made, but they thought that they made it clear that when it got to the Senate side that they could—that their members could come forward and express deep concerns that they have about the legislation and anything new that would come up that they would talk about as well.

And I will say, and I think there is a disagreement on whether the EEI said they would not raise the matter on the floor or not, and I do not know.

Senator **Bumpers**. I will be frank with you, I do not know how anybody could oppose this bill with the House amendments on it. I am not sure I would accept the House amendments, but it seems to me like they went out of their way and leaned over backward over there to accommodate most of the concerns you had.

When they say no refunds will be permitted where it would adversely affect the public interest, you can drive a wagon and a team through that one.

Mr. **Mundy**. Well, I have a bigger wagon, I guess, Senator Bumpers, that I would like to drive on this issue, but if we could, really, if something could be done on the floor—and I am speaking for myself, not EEI at the moment, and I am speaking for my client, the Southern Company, if something could be done with respect to the interchange and pooling arrangements and with respect to the unlimited risk, I believe that we would not object to the bill, particularly as it applies to cooperatives and municipalities.

Senator **Bumpers**. It seems to me you are saying we trust FERC as long as we are asking for an increase, but we do not trust them if anybody else is asking for a refund.

Mr. **Mundy**. No, sir, that is not really true, and what they say, and truthfully they say is that, well, all FERC is going to do is set a just and reasonable rate at the conclusion of this 206 proceeding. Well, I submit to you, if that is all they are going to do, then they could set a reasonable floor in the beginning so everybody will know what their obligation is.

That is not hard to do, really. It is not asking for a lot, I submit to you.

Senator **Bumpers**. As long as FERC is committed to, say, 14 percent return, how can you be hurt, if they are not going to require a refund for anything that would take your rate of return below the just and reasonable rate which they have determined to be, say, 14 percent?

Mr. **Mundy**. I am just like Mr. Jackson who said I am not worried about what you do on the equity return. I am really concerned about allocating capacity around and leaving a utility with the bag with nobody to pay for it. That is what I am really concerned about. Adjusting the equity return up and down and arguing over that, there are not enough dollars in that to affect the financial viability of most utilities, and the one that would be affected most is probably Mr. Berlin's client.

But I really am concerned about these interchange pooling arrangements. It is serious business. We have hundreds and hundreds of millions of dollars flowing back and forth in those, and we have got to know with certainty we are going to get those revenues.

Mr. **O'Neil**. Mr. Chairman.

Senator **Bumpers**. Yes, Mr. O'Neil.

Mr. **O'Neil**. Mr. Mundy made a couple of points that I think are valid. One is that if the Commission is really faced with an extremely urgent situation, it has shown the ability to act quickly, that it has done this both in a 205 situation when a utility proposed to terminate service, and indeed, it set up a fast track, at least in the Yankee cases.

I think it is important to recognize that the exposure of, let's say, the FERC initiating the 206 proceeding under the initial, the existing law, and then disallowing some transaction, the calamity, if you will, of the loss of a revenue stream if the FERC finds that some action should be disallowed, is going to occur. What we are really talking about is the difference between, let us say, the date that the complaint is filed, the five months that it could have been suspended by the Commission that was a deferral of the refund obligation, and then when a decision is coming out, it is a finite period. It is not necessarily an open-ended period.

And there is very clearly the possibility, if you do have the extraordinary circumstance, where a delay by the committee in rendering a decision ~~—~~could have some adverse impacts, some quantifiable adverse impact. The FERC, even under the proposed legislation, would have the ability to expedite and render a 206 decision such that you would not have this perceived cloud, to the extent that it does exist.

We are not talking about a situation where the entire revenue stream for some untold future period and some unspecified historic period is at risk. That is just not the case. We are just talking about that, you know, trying to get, again, this basic symmetry. In the extraordinary situation the FERC retains the discretion not only to expedite, but not to allow the refunds.

Senator BUMPERS. You see, there is another thing that I think is really meritorious about this bill, and that is this. I think if somebody files an application under a 206 proceeding, Jerry, and let's assume just for illustration that somebody files a lawsuit, and they say because of your interest cost or a host of other things, that the 14 percent return that you are entitled to on your Grand Gulf investment has suddenly escalated to 20 percent. We will say you are making 6 percent more than FERC originally allowed you.

Now, if nobody complains, and I am sure that utility companies have found themselves in this position many times—if nobody complains, you are going to keep collecting that 20 percent.

On the other hand, if somebody does complain, you know on the front end that they are likely to prevail because you know that you are getting a bigger return than what FERC has decided was just and reasonable.

And it seems to me that by equalizing 205 and 206 proceedings, the pressure is on you to admit that and immediately get that matter settled.

And why is that not equitable for all concerned? You are still getting a return that your bondholders thought you were going to get, and the consumer is still getting the benefit of not paying more than he ought to be paying.

Why is that not the best of all worlds?

Mr. JACKSON. Mr. Chairman, again we are talking about a factual situation that is not the one that we perceive to be the problem.

I would reiterate what Mr. Mundy said. If we are just talking about a differential in rate of return, that is one thing, and I think you are right. And also, if we knew that the maximum exposure that would come out of a decision by the FERC, once it is made, is only that area between a 16 percent return and a 14 percent return, then we at least have a range of certainty that we can deal with.

The concern we have is that there are other transactions where it may not be that easy to quantify. You may have a complaint that deals with allocation issues and such as that where you are talking about dollars that would be more than a difference between 16 percent and 14 percent. You do not know where it might end up.

As you know, Mr. Chairman, in the *Grand Gulf* case, what the company filed and what the other parties filed was not what ended up by the FERC, and it is that unpredictability that we are concerned with in areas that have the greatest financial impact on the companies.

That is why, quite honestly, if we are talking about differences in rate of return, particularly in those areas not involving intersystem agreements, then I think we would have a different position on this bill than we do with this one. I think I would agree with Mr. Mundy, if we could deal with the problem of the intersystem transactions and also to establish some sort of certainty with respect to the dollars that are at risk, you are right, we can deal with that. We can discount those dollars.

But our problem, we are dealing with really an indeterminate refund liability that no one will know, and the problem we are talking about is that period of time from whenever the refund effective date is established until the FERC makes its decision.

Again, I want to re-emphasize, we are not talking about beyond that point. We are only talking about the uncertainty until the FERC makes its decision. And there could be—if it is 600 days, you could have a utility that cannot finance for 600 days. And that is the problem we are trying to avoid.

Senator BUMPERS. Mr. Scully, do some of the electrical cooperatives, rural electric cooperatives, a lot of them sell power at wholesale, too, do they not?

Mr. Scully Yes, that is true, and Mr. O'Neil can probably elaborate on that.

Senator BUMPERS. Mr. O'Neil, do you want to address that?

Mr. O'NEIL. That is correct, Mr. Chairman, and as a matter of fact, I represent a cooperative that is an FERC jurisdictional utility. It is Golden Spread Electric Cooperative. And if this bill passes, we will be subject to it.

Senator BUMPERS. Jerry, let me ask you one final question.

Under your systemwide agreements, particularly on Grand Gulf, sales of power from Middle South Energy to AP&L, is a wholesale sale of power, is it not?

Mr. JACKSON. That is correct, Mr. Chairman.

Senator BUMPERS. That is the way we got FERC jurisdiction in this case.

Mr. JACKSON. That is correct.

Senator BUMPERS. Now, in light of that, what if this is a fact but relatively unknown, and the Public Service Commission does not take the initiative to do something about it, right now you are entitled to a 14 percent return on sales from Middle South Energy to AP&L.

Mr. JACKSON. That is correct, Mr. Chairman.

Senator Bumpers. What if because Middle South Energy, Inc.'s costs have declined, that you are suddenly making a 20 percent return on your sales to AP&L, but APO&L is a wholly-owned subsidiary of Middle South Utility, as is Middle South Energy. Who would raise that issue?

Mr. Jackson. Well, again, Mr. Chairman, I think that is the example that I pointed out before. Under 206—I think 206 has worked in the *Grand Gulf* case. The Louisiana Public Service Commission made a complaint filing in September of 1986. The FERC——

Senator Bumpers. It worked except for one thing. You got a year's free ride before it was settled, 10-month free ride before it was settled.

Mr. Jackson. Mr. Chairman——

Senator Bumpers. I am not getting into the merits of the case. I am just looking at it clinically and legally and saying the complaint was filed in September of 1986 and it was not settled until July, was it, or August of 1987.

Mr. Jackson. Effective July 1, 1987.

Senator Bumpers. And there was no retroactive payment in it.

Mr. Jackson. No retroactive, that is correct, Mr. Chairman. One thing I think should be pointed out is that—that should not be equated with the period of time that might work on the other side in a utility filing for a rate increase because——

Senator Bumpers. Why not, because you would have gotten the increase within 2 months if it was determined to be meritorious.

Mr. Jackson. That is assuming that we could make the filing instantaneously from the decision to make a filing, and as has been pointed out, there is at least a 6-month period of time that a utility must have to prepare the necessary proceedings to make a filing with the FERC for an increase.

On the other hand, all the LPSC would have to file, for example, in the Grand Gulf is essentially a petition that says we have reason to believe this rate is unjust and unreasonable. They did not even quantify. They did not even say how much it might be. They just said we have reason to believe because interest rates have come down that this rate is unjust and unreasonable, and asking the FERC to make an investigation, and that is how the process started.

So what I am saying, you are not starting from the same point in time. There is no preparation really required on a 206 proceeding that would be required for a 205.

So I would say it is probably equivalent to what would have been the result under a 205 proceeding if you really get the correct starting point.

Senator Bumpers. Mr. O'Neil?

Mr. O'Neil. Mr. Chairman, there has been some discussion about FERC procedures, and I think it should be clarified. It is true that FERC rate increase proceedings are predicated upon estimated data, but the reason the FERC went to the future test year was to benefit the utilities, to allow them to be able to project a future cost. In other words, they could use a test year, a future year, and estimate what the increases would be, and virtually every single period 2, which is the future test year and compared with the period 1 actual, shows higher costs.

The utility can file the rate increase and put the rate into effect up to 3 months prior to the beginning of this future test year. So if a utility were to use a calendar year 1988 test year, they can actually start collecting that rate increase on October 1 of 1987, three months prior to this test year. And I have seen this done where plants are coming in service and the utility adds it to rate base, and they start——

Senator BUMPERS. Maybe we need another bill to address that.

Mr. O'NEIL. Well, you know, the world is not always fair. I mean, we are trying to rectify one small thing.

In terms of the suspension, the maximum suspension on an increase is 5 months. That is the statutory maximum. The FERC has adopted a policy called the West Texas Rule, which I had the dubious distinction of having been involved in that case. My clients lost the maximum suspension there, where the Commission determined that if an increase were no more than 10 percent excessive, not fully justified, only excessive by an amount that they estimate to be only 10 percent excessive, they would suspend it for 1 day. If the Commission comes to the conclusion that it is excessive by more than 10 percent—this is excessive—then they would impose the 5 month suspension.

But what does that mean if the utility has requested an effective date of October 1, 3-months prior to their period 2 test year? It means the effective maximum suspension is 2 months on the test year.

If we go into a 206 complaint proceeding, the utility is going to have an opportunity to present a rebuttal case, and I am willing to bet that any utility would be coming in again with a future period saying, well if you predicated your complaint upon these historic factors, they are not going to apply in the future, and we think the costs will go up, et cetera. The Commission is going to have to make a decision as to what is the just and reasonable rate.

Now, I do not think that you can legislate the method that the Commission uses. The Commission has decided that with regard to rate increases that they will look at future test years.

I think the key thing to bear in mind here is that what we are looking for is an opportunity to at least identify those revenues that are above just and reasonable, that are excessive, that we submit that no investor has an entitlement to count on excessive revenues, and have the opportunity at least to get those back to the customers.

Senator BUMPERS. One final question.

Jerry, you alluded to the 6-month period which it takes you to prepare an application.

Just briefly, is that a 6-month period it takes you to prepare all the information that is required? That is not because of a particular time table that FERC sets, is it?

Mr. JACKSON. No, Mr. Chairman.

Senator BUMPERS. You are just saying normally it takes you 6-months to get prepared for a rate increase and put all the data together that they required.

Mr. **Jackson**. That is right. FERC has fairly rigorous standards to meet when you make a filing.

One point I want to be sure I make with respect to Grand Gulf. We have had a lot of discussion with respect to Grand Gulf, and quite honestly, in large measure I do not think it is really relevant to a 205, 206 discussion because I want to emphasize that Grand Gulf charges are collected pursuant to a formula rate. It is not a fixed rate schedule like most rate schedules we have been talking about. Any decrease in costs, taxes, anything like that that might come down are immediately reflected in that rate schedule. The only thing that is fixed and would require the FERC to readdress in a 206 proceeding is that rate of return only.

I just wanted to be sure that was clear. You would not have—testimony has been made that your costs may go down and you would be able to essentially keep that differential. We are really not able to do that, and I just wanted to be sure the record was clear on that.

Senator **Bumpers**. I think I understood that.

Gentlemen, you have all given good testimony. You have acquitted yourselves well, and I appreciate very much your indulgence this afternoon in being with us.

Thank you.

The committee will stand in recess, and the record will remain open for further testimony and answers to questions.

[Whereupon, at 4:15 p.m., the hearing adjourned.]

APPENDIXES

Appendix I

Responses to Additional Questions

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

CHAIRMAN

December 23, 1987

Dear Mr. Chairman:

In response to your request of November 16, 1987, I am pleased to submit a Federal Energy Regulatory Commission staff analysis of S.1567 and H.R. 2858.

If I can be of further assistance in this or any other matter, please do not hesitate to contact me.

Sincerely,

Martha

Martha O. Hesse

Honorable J. Bennett Johnston
Chairman, Committee on Energy and
Natural Resources
United States Senate
Washington, D.C. 20510

FERC STAFF ANALYSIS OF S.1567 AND H.R. 2858

S.1567 essentially is identical to the version of H.R. 2858 which was introduced in the House of Representatives on July 1, 1987. On October 5, 1987, FERC Chairman Hesse submitted to the House Subcommittee on Energy and Power a memorandum (copy attached) containing general comments on the House bill. That memorandum made two major points. The first was that the plain language of H.R. 2858 would have required the Commission to order refunds from the date rates are found to be unjust and unreasonable under section 206. In contrast, section 205 states that the Commission "may" order refunds if rates are found to be unjust or unreasonable. Under section 205, the Commission normally orders refunds where rates are found to be unjust and unreasonable. However, there could be occasions where refunds would not be appropriate. For example, a utility's financial viability and ability to serve customers could be jeopardized if huge refunds were ordered. The original version of H.R. 2958 would have precluded the Commission from weighing the equities in a particular section 206 case.

The second general concern raised in the memorandum was that the language of H.R. 2858 was ambiguous as to when the Commission would be required to establish the refund effective date, and could be interpreted as requiring that the date be set at the conclusion of a section 206 proceeding. The memorandum stated that if the intent of the legislation is to track the suspension authority granted the Commission in section 205, and to give the utility an up-front indication of the date refunds might attach, this needed to be clarified.

Both of these concerns were addressed in the amended version of H.R. 2858 which was reported from the Energy and Commerce Committee and passed by the House on October 28, 1987. The House-passed bill gives the Commission authority not to order refunds if it determines that such refunds would adversely affect the public interest. The bill was also revised to make it clear that the Commission is to set the refund effective date at the time it institutes a Section 206 proceeding.

Two comments are in order with respect to the House-passed bill. First, the House bill states that the burden of proof in a Section 206 proceeding is on the complainant. The existing Section 206 does not refer to burden of proof. Under the existing Section 206, the burden of proof is controlled by Section 556(d) of the Administrative Procedure Act (APA), which imposes the burden on "the proponent of a rule or order." 5 U.S.C. section 556(d) (1977). This has been interpreted as the burden of coming forward with a *prima facie* case, not the ultimate burden of persuasion. *Environmental Defense Fund, Inc. v. EPA*, 548 F.2nd 998, 1012-15 (D.C. Cir. 1976), *cert. denied sub nom. Velsicol Chemical Corp. v. EPA*, 431 U.S. 925 (1977). Once a *prima facie* case is presented, the burden shifts to the utility to make a persuasive defense. *Nantahala Power and Light Company*, 19 FERC 61,152 at 61,276 (1982), *reh'g denied*, 20 FERC 61,430 (1982), *aff'd*, 727 F.2d 1342 (4th Cir. 1984); *Public Service Co. of New Hampshire*, Opinion No. 37, 6 FERC 61,299 at 61,710-11 (1979). Presumably, the language in the amended bill would track the APA standard, and would not change the historical burden of proof in a Section 206 proceeding. In order to avoid any misunderstanding regarding this, it would be desirable to have it clarified in the conference report.

Second, the House-passed bill also provides that any Section 206 motion or complaint shall state plainly, to the extent practicable, the change or changes to be made in the existing rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein. The existing section 206 does not contain any similar provision. However, the language added by the House may help prevent frivolous claims from being filed at the Commission, by requiring a threshold of specificity.

As a general matter, the refund provisions of S.1567 and H.R. 2858 would act as an incentive for parties not to delay section 206 proceedings. Additionally, once the Commission has issued an order finding existing rates to be unjust and unreasonable and ordering new rates to be filed, the utility would have greater incentive to submit a compliance filing which conforms to the Commission's order. This is important in view of the fact that two courts have recently held that section 206 rates will not become effective until the date of a Commission order accepting a compliance filing which details the rates. *Electrical District No. 1 v. FERC*, 774 F.2d 490 (D.C. Cir. 1985); *Public Service Company of New Mexico v. FERC*, *et al*. No. 82-1148, *et al*. (10th Cir. Nov. 4, 1987).

S.1567 and the amended H.R. 2858 would not change the existing requirement that in a section 206 proceeding the Commission must first find the existing rate to be unjust and unreasonable, and then determine the rate which is just and reasonable. Nor would they change the criteria used to determine justness and reasonableness. Further, the bills appear to provide sufficient discretion to the Commission to work out the practicalities of implementing the legislation. At this time it appears that the Commission would be able to make its refund effective date decision based on information on file with the Commission.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D C 20426

CHAIRMAN

December 23, 1987

Dear Mr. Chairman:

Thank you for your letter dated December 2, 1987, enclosing a set of post-hearing questions associated with the Senate Committee on Energy and Natural Resources November 18, 1987 hearing on S. 1567 and H.R. 2858, the "Regulatory Fairness Act."

I appreciate your interest and am pleased to submit the enclosed responses which were prepared by the Commission's staff.

If I can be of further assistance, please do not hesitate to contact me.

Sincerely,

Martha

Martha O. Hesse

Enclosure

Honorable J. Bennett Johnston
Chairman, Committee on Energy
  and Natural Resources
United States Senate
Washington, D.C. 20510

Questions for the Record from Senator J. Bennett Johnston

Question 1: One interested party has suggested that the Commission's authority to dismiss frivolous, insubstantial, or speculative complaints should be made explicit in statutory language. Does the Commission in fact have this dismissal authority at present? If so, would it be helpful for this authority to be made explicit?

Answer: The Commission presently possesses authority to dismiss complaints, where appropriate. Section 306 of the Federal Power Act, 16 U.S.C. § 825e (1982), provides that complaints may be filed against licensees and public utilities for violations of the Act. The provision states, in part, that where there appears to be any reasonable ground for doing so, the Commission shall investigate the matters raised in the complaint. Thus, where the complainant does not raise any reasonable ground, the Commission is not required to investigate a complaint and may dismiss it. The Commission is also authorized under section 309 of the Federal Power Act, 16 U.S.C. § 825h (1982), to issue such orders as it finds necessary or appropriate to carry out the provisions of the Act.

Amending the Federal Power Act to state more explicitly the Commission's authority to dismiss complaints could help deter persons from filing frivolous, insubstantial, or speculative complaints, but it would appear that sufficient authority already exists.

Senator J. Bennett Johnston, cont.

Question 2: The figures you have previously provided on the average length of time it takes to resolve Section 206 proceedings included rate decreases together with non-rate proceedings.

a) Please provide a separate breakdown of the average length of time it takes to resolve rate decreases together with the same information for non-rate proceedings.

b) Please provide some typical examples of the sorts of issues raised in non-rate proceedings under Section 206.

c) Does the Commission devote more resources to Section 205 proceedings because of the admonition in subsection (e) to resolve such cases "as speedily as possible"?

Answer 2:

a) The Commission staff previously reported 647 days average time between filing date and disposition of section 206 complaint dockets. Section 206 rate level proceedings were completed on average in 745 days, while non-rate level proceedings were completed on average in 625 days.

b) Typical examples of non-rate proceedings under section 206 include contract interpretation disputes, alleged violations of contract terms, improper inclusion of otherwise recoverable items in automatic fuel adjustment clauses, improper billing practices, and bill payment controversies.

c) The Commission manages its resources to resolve all proceedings as quickly as possible regardless of the FPA section under which a case is initiated.

Senator J. Bennett Johnston, cont.

Question 3: At the Committee's hearing, certain witnesses suggested that the proposed legislation should distinguish between sales to traditional wholesale customers on one hand and interconnection, power-pooling, intra-system, coordination or joint ownership agreements on the other. In terms of the additional risk for utilities created by either S. 1567 or H.R. 2858, do you see any basis for distinguishing between these kinds of transactions?

Answer 3: Coordination transactions, power pooling arrangements, and other types of voluntary agreements do not warrant different treatment under either the existing or proposed section 206. If a complaint is filed which alleges that excessive revenues are being collected pursuant to a coordination transaction or power pooling arrangement, the same arguments that would support the imposition of section 206 refund protection to traditional wholesale electric power relationships also appears to support the imposition of section 206 refund protection for non-traditional, interchange transactions. Moreover, when a coordination or power pooling arrangement is originally filed under section 205, refund protection attaches. If the intent of the proposed legislation is to parallel the refund protection accorded under section 205, then refund protection should also attach to section 206 complaints involving interchange transactions. Under section 205 or H.R. 2858, the Commission would retain ultimate discretion as to whether refunds would be in the public interest.

Questions for the Record from Senator Dale Bumpers

Question 1: How many FERC-jurisdictional investor-owned utilities have voluntarily filed for rate reductions to reflect the corporate tax rate change, in accordance with the final rule issued in Docket No. RM87-4-000? How many companies did not file by the appropriate date?

Answer 1: The proceedings in Docket No. RM87-4-000, which culminated in the issuance of Order No. 475, applied only to electric utilities providing firm service (requirements and transmission) to wholesale customers. There are approximately 150 electric utilities regulated by the FERC that are eligible to make Order No. 475 rate reduction applications.

To date, 34 utilities have made such filings in whole or in part; 2 have declared their intention to make a filing but have requested extensions of time in which to do so; and 32 have adjusted their rates either through rate increase or rate decrease filings outside the scope of Order No. 475. These latter filings include changes to reflect the lower corporate income tax rate.

Of those utilities that have not filed, staff has ascertained from available data that no rate reductions are warranted for 38 of these non-filing utilities. Negotiations with 4 other utilities are underway or are being contemplated to effect rate reductions. The remaining 40 non-filing utilities, as well as those that may not have filed Tax Reform Act of 1986 (TRA)-related rate reductions for other eligible rate groups, are currently under review.

Senator Dale Bumpers, cont.

Question 2: What action does the Commission intend to take if necessary against any delinquent company in Docket No. RM87-4-000? How long will any FERC action against a delinquent company likely take?

Answer 2: For those companies that choose not to file voluntary rate reductions to reflect the TRA, the Commission staff intends to perform a preliminary analysis based upon available information in order to ascertain whether the rates presently on file may be generating excessive revenues. It is possible that some utilities that have not filed may have incurred additional costs which may more than offset any indicated reduction in income tax expense under the TRA. An example of such incurrence would be a major new plant coming on line. In those cases where the preliminary analysis indicates that the currently effective rates are excessive, the staff will recommend that the Commission undertake a section 206 investigation into the utility's cost of providing service. The timeframes for completion of a formal proceeding have ranged from 6 months to 53 months, depending upon the complexity and number of issues that will arise, the additional data requirements imposed by those issues, and the Commission's manpower constraints. If the parties are able to achieve a settlement, the necessary rate reduction may be accomplished in a shorter period of time.

Senator Dale Bumpers, cont.

Question 3: a) How many full-time staff members at FERC audit on a regular basis the annual reports and other reports of jurisdictional utilities to ascertain possible overcollections? b) How many section 206 rate proceedings have been initiated in the last 10 years as a result of FERC-initiated audits and investigations? What time period elapsed between the date of the audit and the rate decrease? How did the approved rate compare with the prior rate and with the rate initially sought by FERC staff?

Answer 3: a) During periods of rising costs, most investigations staff members work full time processing and litigating utility requests for additional revenues. During periods of declining costs, staff members are assigned to rate surveillance activities under which they audit utility data on file with the Commission to identify revenue overcollections. The decrease of capital costs, the reduction in the corporate income tax rate, the completion of current utility construction programs, and the slow down in inflation are all recent examples of declining costs that have resulted in approximately 20 full-time staff members devoting at least half of their time to rate surveillance.

b) The first 7 of the last 10 years can be characterized as a period of generally rising costs, during which section 206 investigations were inappropriate. However, in the last three years, there have been five section 206 rate proceedings initiated by the FERC on its own motion. They were:

Yankee Atomic Electric Company	EL87-21-000
Vermont Yankee Nuclear Power Corporation	EL87-22-001
Connecticut Yankee Atomic Power Company	EL87-23-000
Connecticut Light and Power Company	EL87-30-000
Safe Harbor Water Power Corporation	EL88-2-000

The last two cases are still pending final Commission disposition. Formal investigation of the first three cases was instituted on March 26, 1987 and Opinion No. 285, which disposed of all three cases on a consolidated basis, was issued on September 30, 1987. Those three cases are now pending on rehearing. The new rates will become effective as of the date a compliance filing is accepted by the Commission. The compliance filing is to be filed no later than 45 days after the order on rehearing is issued. A comparison of the approved rate in the three litigated cases and the rate initially sought by FERC staff is shown in the response to Question 2.

Senator Dale Bumpers, cont.

The following chart compares the prior return on common equity, the equity return proposed by staff, and the equity return approved in Opinion No. 285:

	Prior Rate	Staff Proposal	Opinion 285
Yankee Atomic	14.5%	11.5%	12.0%
Vermont Yankee	15.0%	11.7%	12.0%
Connecticut Yankee	17.0%	11.5%	12.0%

There were approximately 10 other cases that were the subject of rate surveillance activities by staff and resulted in voluntary reductions in the equity return being filed by the utility. In those cases, it was unnecessary to initiate a formal investigation.

Senator Dale Bumpers, cont.

Question 4: If a company in poor financial health is involved in a section 206 proceeding, does the House-passed bill grant sufficient authority to the Commission to waive the refund obligation if appropriate?

Answer: Yes. In deciding whether a refund obligation should be waived under the House-passed bill, the Commission would need to determine whether such refund would adversely affect the public interest. In making such a determination, the effect on a utility's financial viability and ability to serve customers would be an important consideration.

Senator Dale Bumpers, cont.

Question 5: In your view, is the financial test outlined by Middle South Utilities an appropriate determinant of poor financial health? What would be the effect of establishing in this legislation a definition of poor financial health that would automatically result in waiving a refund? Should such a specific test be written into the Federal Power Act?

Answer: Middle South Utilities System has suggested that a ceiling be set on the amount of revenues that would be subject to refund, "such as by ensuring that the refund would not jeopardize a utility's ability to meet its financial coverage ratio tests necessary to enable it to finance and issue new securities." (Testimony of Jerry D. Jackson, November 18, 1987.) This test would restrict the ability of the Commission to determine, on a case-by-case basis, whether the public interest requires that refunds not be imposed. It may be difficult or impossible to construct a definition of "poor financial health" that would be appropriate for all conceivable situations.

Senator Dale Bumpers, cont.

Question 6: Do the equity reopener cases recently litigated at FERC include a refund component? Has the Commission ascertained any diminution in the financial integrity of the companies involved in these cases? If so, please state what the dimunition was and the causal connection between such diminution and the Commission's section 206 actions.

Answer 6: In Opinion No. 285, issued September 30, 1987, the Commission endorsed the concept of an equity reopener to be applied to automatically adjusting formula rates. The Commission imposed a reopener provision on Yankee Atomic Electric Company, Vermont Yankee Nuclear Power Corporation, and Connecticut Yankee Atomic Power Company. The equity reopener provides that, on an annual basis, a party may file a complaint regarding the utility's return on equity. If the complaint is set for investigation, a refund liability would attach from the later of sixty days after the complaint is filed or the date of the Commission's order setting the matter for hearing. Rehearing of Opinion No. 285 is pending before the Commission.

The Commission has not at this time ascertained any diminution in the financial integrity of the companies subject to Opinion No. 285.

Senator Dale Bumpers, cont.

Question 7: How many jurisdictional investor-owned utilities have notes to their financial statements? What is the nature of these notations? What kind of notes does FERC believe result in significant increases in the cost of capital to the utility?

Answer 7: Most, if not all, investor-owned utilities have notes to their financial statements. In general, these notations explain or qualify cost and revenue figures reflected in a utility's financial statement. Examples would include outstanding litigation, pending regulatory approvals, the possibility of refund obligations, and other types of contingent liabilities that may underlie accounting representations made by a utility. The kinds of notes that are likely to result in significant increases in the cost of capital to the utility would be those where the magnitude of the liability is very large and the ultimate disposition of the liability is highly uncertain.

Senator Dale Bumpers, cont.

Question 8: Does the FERC require the establishment of escrow accounts for potential refunds under section 205? Do utilities customarily establish such escrow accounts?

Answer 8: No. The FERC does not require the establishment of escrow accounts for potential refunds under section 205 and utilities do not customarily establish such accounts.

Questions for the Record from Senator Howard M. Metzenbaum

Question 1: In evaluating whether a settlement in a Federal Power Act (FPA) section 206 case is in the public interest, does FERC currently consider that an early resolution of the pending issues resulting in quick, moderate rate relief for consumers would be preferable to litigation, where rate reductions may be substantially greater, but would take effect much later? If your answer is yes, please discuss how important early relief is generally in the agency's evaluation of this issue. If your answer is no, please explain why the early rate relief should not be considered a significant factor.

Answer: The Commission's litigation staff has the responsibility to evaluate settlement options and seek to negotiate a settlement among the parties to a section 206 proceeding. In analyzing settlement options, the litigation staff recognizes that rate relief obtained through settlement is more certain and is available earlier. The staff's recommendation as to whether a settlement option best serves the public interest is based in part on its estimate of the timing and the extent of rate relief which would result from litigation.

Senator Howard M. Metzenbaum, cont.

Question 2: Under S. 1567, would a utility be required to set aside potential refund amounts, plus interest, if it believed that a section 206 complaint filed against it was frivolous?

Answer: No. S. 1567 does not contain any requirement that a utility set aside potential refund amounts.

Senator Howard M. Metzenbaum, cont.

Question 3: Does FERC have either formal or informal standards to dismiss insubstantial complaints filed under section 206 to protect investor-owned utilities? If yes, please reference and explain.

Answer: Section 306 of the Federal Power Act, 16 U.S.C. § 825e (1982), provides for the filing of complaints "of anything done or omitted to be done by any licensee or public utility in contravention of the provisions of" the Act, and, where any reasonable ground exists, for the investigation of the complaint. Similarly, Rule 206 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.206 (1987), provides that any person may file a complaint seeking Commission action against any other person alleged to be in contravention or violation of any statute, rule, order, or other law administered by the Commission, or any other wrong over which the Commission may have jurisdiction. Although section 306 does not specifically address the Commission's authority to dismiss insubstantial complaints, the Commission implicitly has the authority to dismiss a complaint that does not raise any reasonable ground to proceed with an investigation.

In determining what action to take with respect to specific complaints, the Commission does not have formal standards but acts on a case-by-case basis.

Senator Howard M. Metzenbaum, cont.

Question 4: If S. 1567 were enacted, should the agency issue a proposed rule delineating its standards and procedures for dismissing impalpable complaints? What criteria would the agency seek to incorporate into a final rule? Would the requirement that a complainant quantify the excessive charges be advisable?

Answer: Complaints involve a wide variety of factual, legal, and policy questions, and it would be extremely difficult to issue a rule which could adequately define an "impalpable" complaint so as to pertain to all situations. However, a requirement that the complainant attempt to quantify the charges it believes to be excessive would be helpful since it might assist the Commission and the utility in estimating the potential refund obligation. In addition, such a requirement could be helpful to the Commission in determining whether a complaint is frivolous.

Senator Howard M. Metzenbaum, cont.

Question 5: If S. 1567 were enacted, would it be necessary or advisable to issue a rule mandating sanctions for the filing of a frivolous complaint or engaging in dilatory tactics? What types of penalties would be necessary to inhibit these tactics?

Answer: It is not at all clear that the Commission would have authority to issue such a rule. In any event, it does not appear that such a rule would be necessary or advisable. A utility is protected from spurious complaints by the Commission's evaluation of the complaint -- such complaints do not result in an investigation unless the Commission concludes there is some merit to the complaint.

Senator Howard M. Metzenbaum, cont.

Question 6: Are the structures of power pooling, coordination, or other voluntary agreements sufficiently different from the structure of traditional wholesale electric power relationships so as to warrant different treatment under either the existing or proposed section 206? Please explain.

Answer 6: Coordination transactions, power pooling arrangements, and other types of voluntary agreements do not warrant different treatment under either the existing or proposed section 206. If a complaint is filed which alleges that excessive revenues are being collected pursuant to a coordination transaction or power pooling arrangement, the same arguments that would support the imposition of section 206 refund protection to traditional wholesale electric power relationships also appears to support the imposition of section 206 refund protection for non-traditional, interchange transactions. Morever, when a coordination or power pooling arrangement is originally filed under section 205, refund protection attaches. If the intent of the proposed legislation is to parallel the refund protection accorded under section 205, then refund protection should also attach to section 206 complaints involving interchange transactions. Under section 205 or H.R. 2858, the Commission would retain ultimate discretion as to whether refunds would be in the public interest.

Senator Howard M. Metzenbaum, cont.

Question 7: In the opinion of your General Counsel, would the enactment of S. 1567 give FERC the power to redetermine prior clean rates and to order refunds retroactively, or would rate relief be prospective from a date certain after notice and opportunity to comment on the procedural and substantive aspects of a complaint?

Answer: S. 1567 would give the Commission the power to grant rate relief prospectively from a date certain. This date could be not less than 60 days from the date of the filing of a complaint under section 206 or from the date of publication by the Commission of its intention to initiate a hearing under section 206.

Senator Howard M. Metzenbaum, cont.

Question 8: In the opinion of the FERC General Counsel, would the enactment of S. 1567 overrule, distinguish, or alleviate the "filed rate" doctrine? Could the amendment present any constitutional problems? Please explain in detail.

Answer: The "filed rate" doctrine prohibits a utility from charging rates other than those properly filed with the Commission. Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981); Montana-Dakota Utilities Co. v. Northwestern Public Service Co., 341 U.S. 246 (1951). The considerations underlying the doctrine are preservation of the agency's jurisdiction over the reasonableness of rates and the need to insure that regulated companies charge only those rates of which the agency has been made cognizant.

S. 1567 would, if enacted, permit the Commission to order refunds in proceedings instituted pursuant to section 206 of the Federal Power Act, 16 U.S.C. § 824d (1982), no earlier than 60 days after the filing of a complaint or publication of notice of the Commission"s intent to initiate proceedings, and no later than 5 months after expiration of the 60-day period. The proposed legislation also appears to grant the Commission the authority to establish revised rates as of the refund-effective date. In these circumstances, enactment of S. 1567 would not appear to overrule, distinguish, attenuate, or otherwise create difficulties with respect to the "filed rate" doctrine. For both the period preceding the refund effective date and the period subsequent to the refund effective date, the public utility would be collecting rates on file with and/or fixed by the Commission.

As to whether the proposed amendment presents constitutional problems, the Office of the General Counsel is unable to render a definitive opinion in view of the limited time available. However, it should be noted that regulated utilities would be entitled to notice of the potential for refunds and an opportunity to be heard before refunds are ordered. Further, the proposed legislation limits refunds to amounts paid in excess of the just and reasonable rate. The "just and reasonable" standard coincides with the applicable constitutional standards. Permian Basin Area Rate Cases, 390 U.S. 747, 770 (1968); FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 586 (1942). Thus, the lowest reasonable rate is one which is not confiscatory in the constitutional sense.

Senator Howard M. Metzenbaum, cont.

Question 9: Would you, as FERC Chairman, present your opinions, and the legal opinions of your General Counsel as to the reasons for, and against a floor below which refunds of excessive rates could not sink? Please describe methods for a rate reduction floor to be quantified and codified?

Answer: The advisability of a refund floor is a policy rather than a legal matter. The reason given by advocates of such a floor is that it would protect a utility from exposure to allegedly unlimited refunds. However, utilities are generally able to predict with considerable accuracy the range of possible rate levels the Commission will find to be just and reasonable. They are able to do so based on their access to and familiarity with the analyses the Commission uses, such as the Commission's cost-of-service computer program, the generic rate of return, and the discounted cash flow method of determining return on equity, as well as Commission precedent on various rate issues. Furthermore, the amount of potential refunds would not be unlimited, since the utility's refund liability would date back only to the refund effective date and would not go below a just and reasonable rate.

If a refund floor is adopted, the Commission could make a preliminary analysis of a utility's rates based on data in the Commission's files. The results of that analysis could provide a floor beneath which refunds would not be ordered. If the Commission were to conclude that the just and reasonable rate was below that floor, the new rate could take effect prospectively only.

Senator Howard M. Metzenbaum, cont.

Question 10: Does FERC currently quantify any ceiling for rate increases under section 205 of the FPA?

Answer: No. However, under the Commission's current suspension policy, if the Commission's preliminary analysis indicates that more than ten percent of a proposed increase is excessive, the proposed rate increase generally will be suspended for the statutory maximum of five months. *See* *West Texas Utilities Company*, 18 FERC ¶ 61,189 (1982).

Senator Howard M. Metzenbaum, cont.

Question 11: Have there ever been Commission rules limiting rate increases or decreases?

Answer: There have never been Commission rules which have *per se* limited rate increases or decreases. However, there has been one rule (since revoked) which limited the amount of construction work in progress (CWIP) which a utility could seek to include in its rate base and thus recover in its rates. In Order No. 298, 48 F.R. 24,323 (June 1, 1983), FERC Statutes and Regulations, Regulations Preambles 1982-1985, ¶ 30,455 (1983), the Commission promulgated section 35.26(d) of its regulations, 18 C.F.R. § 35.26(d) (1984). Section 35.26(d) limited the amount of CWIP allowed in rate base in the two-year period July 1, 1983-July 1, 1985 in two respects. First, any rate change filing during this period could not result in more than a six percent increase attributable to allowing CWIP in rate base. Second, any prior rate schedule that included CWIP had to remain in effect for a period of not less than 10 months. Section 35.26(d) expired on its own terms on July 1, 1985. This provision was not included when the Commission re-promulgated its CWIP rule in Order No. 474. *See* 52 F.R. 23,948 (June 26, 1987), III FERC Statutes and Regulations, ¶ 30,751 (1987).

Also, the Commission on June 26, 1987, promulgated Order No. 475, 52 F.R. 24,987 (July 2, 1987), III FERC Statutes and Regulations, ¶ 30,752 (1987). Under Order No. 475, public utilities are permitted to use an abbreviated filing procedure to decrease their rates to reflect the decrease in the corporate income tax rate from 46 percent to 34 percent under the Tax Reform Act of 1986. However, utilities are able to use the abbreviated procedure only for this aspect of the Tax Reform Act. Any other changes must be reflected in a normal rate filing.

Senator Howard M. Metzenbaum, cont.

Question 12: Is the determination of limits for rate changes one where the just and reasonable rate, as determined by the Commission, delineates the floor and ceiling?

Answer: Section 205(a) of the Federal Power Act, 16 U.S.C. § 824d(a) (1982), limits all rates and charges to those which are just and reasonable, and declares all rates and charges which are not just and reasonable to be unlawful. The term "just and reasonable" has been used to refer to rates which lie within a "zone of reasonableness," where rates are neither less than compensatory to the regulated utility nor excessive to consumers. See, e.g., Farmers Union Central Exchange v. FERC, 734 F.2d 1486 (D.C. Cir. 1984).

The Federal Power Act permits a utility, absent a contractual agreement to the contrary or other limitations such as those described in response to Questions 10 and 11, to file changes in rates without limit as to the amount of the increase or decrease. Where the utility files an increase in rates pursuant to section 205(e), the Commission may suspend the rates for up to five months at which time they become effective, subject to refund. The Commission may order refunds, with interest, of any amounts in excess of those found to be justified.

Senator Howard M. Metzenbaum, cont.

Question 13: Several parties opposed to S.1567 claim that unspecified exposure to refunds of excess revenues collected that the Commission may later find to be above the just and reasonable rate will ultimately result in higher bills to consumers. These parties contend that this would be due to the passthrough of higher capital costs as financial markets attach added risk to debt and equity offerings of utilities. Did the interstate gas pipelines make similar arguments to FERC in response to the Notice of Inquiry and proposed rule concerning open access transportation, that resulted in the Order Nos. 436 and 500 series?

Answer: In Associated Gas Distributors v. FERC, 824 F.2d 981 (1D.C. Cir. 1987) (AGD), the court generally upheld the substance of Order No. 436 and the procedures employed in adopting it, but found problems with certain issues and vacated and remanded the matter for further proceedings.

Although the interstate gas pipelines did not directly challenge Order No. 436 on the grounds that any higher risks on pipelines resulting from open access would result in higher bills to consumers, the court dealt with three arguments by pipelines regarding the impacts of open access on pipeline risks.

First, the interstate pipelines appeared to suggest that Order No. 436's impact on their financial integrity would be so grave as to be equivalent to a rule denying them the legal right to pass on costs, and invalid as such a rule would be. The court responded that "petitioners have called our attention to nothing that bars the Commission from devising rules that remedy a lack of competition and its normal consequences. The Supreme Court has made clear, for example, that the due process clause affords no protection from losses inflicted by market conditions." AGD, 824 F.2d at 1001.

Second, some interstate pipelines challenged the rate conditions in Order No. 436 which permit selective discounting of transportation rates, on the grounds that permitting discounts below the maximum rate while not permitting premiums above the maximum would force pipelines to accept a return which would be less than that enjoyed in unregulated industries with corresponding risks. The court rejected this argument because the Commission had specified in its Order No. 436 rate conditions that the maximum rate would be set high enough to assure that the pipeline's revenue requirements were attained by providing the projected units of service. AGD, 824 F.2d at 1012.

Senator Howard M. Metzenbaum, cont.

Finally, in rejecting the Commission's treatment of pipeline take-or-pay problems in Order No. 436, the court noted that the Commission had suggested that pipelines not be treated differently than an ordinary middleman in a competitive market who had entered into unlucky or improvident contracts. In response, the court stated that "while the middleman buying and selling in competitive markets will bear the risk associated with his bad luck or improvidence, the pipeline's market power allows it to pass some of that burden forward." AGD, 824 F.2d at 1027.

Thus, although the interstate pipelines did not directly argue to the court in AGD that the higher risks of open access transportation would result in higher costs to consumers, they did argue, and the court discussed, the indirect impact of various provisions in Order No. 436 on the ability of pipelines to passthrough increased gas costs to consumers.

Senator Howard M. Metzenbaum, cont.

Question 14: When Order No. 436 was issued, representing a significant departure from traditional ratemaking and other regulated industry practices, did the cost of debt or equity for interstate gas pipelines rise appreciably as a result of added risk or uncertainty? If yes, please quantify your answer and provide the duration of such increased financial market costs attributable to regulatory-induced increased risk.

Answer 14: The cost of capital for equity or debt is generally a function of the "markets" valuation of such capital through the price mechanism. Therefore, it is necessary to look to the market prices for the pipeline stocks and to the interest cost for their debt securities for an answer to this question.

It should be noted that interstate pipelines have diversified over the years, so that the stock price reflects the expectations of the entire company, not just the interstate pipeline portion. Even pipelines that are primarily interstate transmission companies derive an average of 25% of revenues from non-pipeline sources.

Order 436 was issued in October 1985. During the period from March 1985 through February 1986, and the 6-month period from September 1985 through February 1986, monthly average pipeline stock prices declined 9.62% and 2.85 %, respectively. In contrast, during the same periods the Standard and Poor's 500 monthly stock index averages rose 22.8% and 19.16%, respectively.

After February 1986, most pipeline stocks rose to higher levels, with some peaking as late as August 1987, along with the general market. During the subsequent stock market drop, pipeline stocks declined in line with the market. However, it is difficult to isolate the effect of any one factor on the price of a stock and to determine at what point in time the factor influenced the stock price. The stock market tends to anticipate changes and reflect them in stock price before events actually occur. Therefore, if Order 436 had any impact at all on stock price and reflectively on the cost of equity, it seems that it was only transitory.

As for the Order's impact on the cost of debt, it is even less defined. Most pipeline bond ratings fell or stayed the same from 1985 to 1986, but this is actually part of a longer term trend. Interest rates for utility bonds, of which gas pipeline are a part, declined almost 3 percent from 1985 to 1986. Thus, even after considering any downgradings, the cost of debt for pipelines declined after Order 436 was issued.

In essence, the cost of debt for pipelines was more the result of the level of prevailing interest rate trends than industry fundamentals.

Senator Howard M. Metzenbaum, cont.

Question 15: In the history of Commission regulation under the FPA and NGA, have the significant increases in cost of debt or equity to the regulated entity been primarily attributable to market-related increases in the cost of debt or equity in the financial markets? If your answer is no, please list and explain any other episodes.

Answer 15: The significant increases in financing costs (as well as significant decreases) to regulated utilities have been primarily attributable to market-related factors. Admittedly, there are industry-specific as well as company-specific factors (e.g., construction programs requiring large capital outlays, denial of ratebase recognition of construction costs, etc.) that can affect the cost of debt or equity for a particular regulated utility. While those factors may drive the cost of capital for a specific company, they do not drive the cost of capital for the industry as a whole to the same degree as general financial market conditions or events.

Similarly, major changes in the cost of debt or equity for regulated pipelines have been primarily attributable to market-related changes in the cost of debt or equity in the financial markets.

Senator Howard M. Metzenbaum, cont.

Question 16: Do you and the FERC General Counsel view the current rate reduction provisions in section 206 of the FPA and section 5 of the NGA as virtually identical? If not, please explain any differences in detail.

Answer 16: The Supreme Court has held that the two provisions are "substantially identical." FPC v. Sierra Pacific Power Co., 350 U.S. 348, 353 (1956); Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1980). However, as discussed in the response to Question 19, the two sections are not exactly identical.

Senator Howard M. Metzenbaum, cont.

Question 17: Does the Commission employ virtually identical standards and procedures in evaluating cases involving section 206 of the FPA and section 5 of the NGA?

Answer: Yes. Section 206 of the FPA is "substantially identical" to section 5 of the NGA. *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 350-51 (1956). Accordingly, the Commission evaluates cases involving section 206 of the FPA or section 5 of the NGA in a similar fashion. However, the Commission reviews section 206 and section 5 proceedings on a case-by-case basis.

Senator Howard M. Metzenbaum, cont.

Question 15. Do the Commission and the courts cite case law and Commission precedent concerning section 5 of the NGA as parallel support for rate or burden of proof principles in FPA section 206 decisions and vice-versa? If your answer is yes, please discuss several examples.

Answer: The courts and the Commission have recognized that sections 4 and 5 of the Natural Gas Act and sections 205 and 206 of the Federal Power Act are similar, and therefore apply precedent decided under one statute in resolving questions arising under the other. For example, the decision in *United Gas Pipe Line Co v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), which held that natural gas companies could not file unilaterally for rate changes where prohibited by their contracts, was applied to public utilities under the Federal Power Act in *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956). In *Sierra*, the court further stated that a public utility could obtain rate relief, however, where the contractual rate was so low as to adversely affect the public interest. The holdings of these cases have become known as the "*Mobile-Sierra*" doctrine and have been applied in numerous gas and electric cases.

A second example of precedent being applied interchangeably under the Natural Gas Act and the Federal Power Act are cases which prohibit utilities from charging rates other than those on file with the Commission, or which hold that the Commission may not order reparations. *See*, *e.g.*, *Public Service Co. of New Hampshire v. FERC*, 600 F.2d 944 (D.C. Cir. 1979); *Montana-Dakota Utilities v. Northwestern Public Service Co.*, 341 U.S. 246 (1951); *FPC v. Tennessee Gas Co.*, 371 U.S. 145 (1962); *State Corp. Comm'n of Kansas v. FPC*, 215 F.2d 176 (8th Cir. 1954).

A third example is the determination of the appropriate return on common equity to be awarded a public utility or natural gas company. The standard was set forth in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1974), a case decided under the Natural Gas Act. In that case, the Supreme Court stated that returns on equity should be: (1) commensurate with returns on investments in other companies with corresponding risks; and (2) sufficient to assure confidence in the financial integrity of the enterprise, maintain its credit, and attract capital. This standard has been applied in such electric utility rate cases as *NEPCO Municipal Rate Committee v. FERC*, 668 F.2d 1327 (D.C. Cir. 1981), and *Public Service Co. of Indiana v. FERC*, 575 F.2d 1204 (7th Cir. 1978).

Senator Howard M. Metzenbaum, cont.

Question 19: As the FERC Chairman, please request that the FERC General Counsel prepare an opinion on the legal impacts of amending FPA section 206 to provide refunds to consumers as contemplated in S. 1567 while not amending NGA section 5 in the same manner.

Answer: While FPA section 206 and NGA section 5 are "substantially identical," FPC v. Sierra Pacific Power Co., 350 U.S. 348, 353 (1956); Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577 n.7 (1980), they are not identical. For example, under FPA section 206, the Commission may increase a public utility's rate if it determines that the existing rate is unjust and unreasonable. Under NGA section 5, the Commission has no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission unless such increase is in accordance with a new schedule filed by such natural-gas company. Thus, under FPA section 206, the Commission can increase or decrease an electric utility's existing rate but can only decrease a natural-gas company's rate absent the filing of a new rate schedule under NGA section 5.

If section 206 of the FPA is amended to provide refund authority to the Commission as provided in S. 1567, while section 5 of the NGA is not amended in the same fashion, there will be a legal impact to the extent that the interchangeability of the precedents construing the two sections will be diminished to a degree in regard to refund authority. However, this should not be a significant problem since the statutory standards set forth in the sections (unjust, unreasonable, unduly discriminatory or preferential) will remain the same in both sections. Thus, most of the precedent concerning the interchangeability of the two sections will remain. However, new precedent will no doubt develop concerning the Commission's refund authority if section 206 is amended as provided in S. 1567, which will not be applicable in proceedings under section 5.

There are also other differences in the authority delegated to the Commission in the FPA and the NGA. For example, public utilities must give the Commission 60 days notice when filing to change rates under FPA section 205. Natural-gas companies, however, are only required to give the Commission 30 days notice.

In conclusion, there will be some legal impact if Congress amends section 206 of the FPA, as provided in S. 1567, but does not correspondingly amend section 5 of the NGA. However, the impact should not be significant.

Senator Howard M. Metzenbaum, cont.

Question 20: In your opinion as FERC Chairman, as a regulatory fairness principle should gas consumers relying on the Commission for protection under the NGA be afforded the same protection that electric consumers receive under the FPA?

Answer: The principles underlying the two statutes are similar, and consumers generally should receive similar protection under both statutes relating to rate regulation of interstate sales and transportation by electric utilities and interstate gas pipelines.

Senator Howard M. Metzenbaum, cont.

Question 21: Middle South Utilities System proposed an amendment to S. 1567 in testimony received by this Committee on November 18, 1987, to preclude FERC from granting refunds if the result would "jeopardize a utility's ability to meet financial coverage ratio tests necessary to enable it to finance and issue new securities." Please provide a legal opinion as to whether an amendment of this type would affect the "end result" test and the deferential standard of court review articulated by the Supreme Court in FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944), and its progeny, particularly the recent decision in Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (D.C. Cir. 1987).

Answer: In Hope, the Supreme Court stated that under the statutory standard of "just and reasonable" it is the result reached, not the method employed, which is controlling; if the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry is at an end. 320 U.S. at 602. The court further noted that ratemaking involves a balancing of investor and consumer interests. Subsequently, in Permian Basin Area Rate Cases, 390 U.S. 747, 791-2 (1968), the Supreme Court stated that the functions of a reviewing court are to: (1) determine whether the Commission abused or exceeded its authority; (2) determine if each of the order's essential elements is supported by substantial evidence; and (3) determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors, while providing appropriate protection to the relevant public interests. The Court stated, however, that a reviewing court's function is not to supplant the Commission's balancing of these interests, but to assure that the Commission has given reasoned consideration to each of the pertinent factors.

Traditional ratemaking practice allows utilities the opportunity to recover the cost of debt and a reasonable return on common equity. In determining the return on common equity, the utility's ability to finance and issue new securities is one of a variety of factors considered by the Commission.

The amendment proposed by the Middle South Utilities System appears to lessen the Commission's discretion insofar as refunds are concerned, by prescribing the narrow standard of relying upon financial coverage ratios to assess a utility's financial condition. Resort to a narrower standard could result in a reviewing court granting less deference to the Commission's expertise and judgment.

Senator Howard M. Metzenbaum, cont.

Question 22: Under the current provisions of the FPA, suppose a utility's last clean filed rate was 100 units. Yet, due to significant declines in the cost of capital, depreciated rate base, lower tax rates, or other decreased costs, the litigated just and reasonable rate could likely be in the zone of 65 units. As a result, the utility files for a nominal rate decrease to 95 units pursuant to section 205 of the FPA. Would the utility be able to charge a rate of 95 units during the pendency of protracted litigation to determine the just and reasonable rate, and not be subject to refunds? How would the FERC remedy this problem under the existing FPA? Would the enactment of S. 1567 address this problem sufficiently?

Answer 22: Under the current provisions of the FPA, a utility that has experienced a significant decrease in costs (from 100 units to 65 units) could file a nominal rate decrease to 95 units under section 205. The utility could legally charge the filed 95 unit rate during the pendency of any litigation. This is because the Commission has no authority to suspend a rate decrease filed pursuant to section 205, nor can that rate be made subject to refund. 16 U.S.C. S 824d(e) (1982), Southwestern Electric Power Company, 37 FERC 61,325 (1986), Wisconsin Pubic Service Corporation 37 FERC 61,312 (1986). Under the current provisions of section 206 of the FPA, any reduction in the rate below the 95 unit level could become effective only prospectively from the date a compliance rate reflecting the reduction is accepted for filing by the Commission.

By providing refund protection during the pendency of the hearing, enactment of S. 1567 would deal with this issue. It would also remove the incentive, if any, for a utility to protract litigation in such situations.

Connecticut Municipal Electric Energy Cooperative
268 Thomas Road Groton, Connecticut 06340
(203) 446-0620
(203) 446-0624

December 15, 1987

The Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
United States Senate
360 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

I am pleased to answer your questions, and those of Senator Bumpers, on the Regulatory Fairness Act (S. 1567, H.R. 2858). The answers are provided herewith. For convenience, I have divided, where appropriate, your numbered questions into lettered subgroups, so that my responses to Question 1, for example, are number 1(a) and 1(b).

I would be pleased to answer any additional questions you might have, or to assist you in any other way. Please feel free to have your staff contact me or Marty Kanner of the American Public Power Association.

Sincerely,

Maurice Scully
Executive Director

Enclosure

MS/mpm

RESPONSES TO QUESTIONS OF SENATOR JOHNSTON

ON THE REGULATORY FAIRNESS ACT

Question 1(a). You note the differences in the time it usually takes FERC to process a Section 205 proceeding as compared to time required to process a Section 206 proceeding. In your opinion, are there any inherent differences in the processing of a request for rate decrease initiated upon complaint as compared to a request for rate increase?

There is one inherent difference that distinguishes Section 205 and Section 206 proceedings: the prospective-only relief granted under Section 206 is a built-in incentive for wholesale power suppliers to delay proceedings. Under current Section 206 proceedings, the wholesale supplier continues to collect under the existing rate until the proceeding is completed and a new rate is fixed. The longer the hearing takes, the longer the company is able to collect the alleged higher rate, and the farther off any resulting rate reduction becomes.

Wholesale suppliers seem to suggest that the problem is merely one of FERC staff resources. The companies cite FERC's expeditious consideration of the Yankee cases to show how Section 206 cases can be handled rapidly if FERC decides to do so. In fact, these cases were easy to expedite, in part because they involved formula rates, where only the return on equity was at issue. Further, these cases were expedited because of a Commission belief that the equity return component was excessive and had been so for some time. It would be discouraging if only those proceedings based on similarly evident gross inequities could receive expedited treatment.

It is also worth noting that FERC used these proceedings to test a provision -- the equity reopener -- that would accomplish, albeit on a significantly more limited basis, a purpose similar to the Regulatory Fairness Act. Despite FERC's ability to expedite these proceedings, the Commission realized that procedural reforms were needed to protect customers from future regulatory lag. This reform, which is being challenged by the companies, would apply only to those schedules using formula rates.

Moreover, these cases have not yet been completed. The companies have filed for rehearing in two of the three Yankee cases. Thus, despite FERC efforts to expedite these proceedings, consumers have yet to receive the benefit of FERC's action.

I would also contrast the timetable in the Yankee cases with another Section 206 proceeding in which I am currently involved. My agency filed a Section 206 complaint in early 1987 seeking a lowered rate for the wholesale power we purchase from Northeast Utilities. The FERC did not act on this complaint, but did initiate a proceeding on its own motion (Docket No. EL87-30). This case was tried and briefed in the same timeframe as the Yankee cases. However, while FERC has issued a final order in the Yankee cases, the Commission has not yet taken up for consideration this other complaint.

Question 1(b). If not, couldn't we address many concerns by admonishing FERC to resolve Section 206 proceedings "as speedily as possible" in the same way the Commission is already required to do under Section 205?

Such an admonishment would be a positive development, but it would not solve the problem. It would not create an incentive for the wholesale power supplier to respond to a Section 206 filing expeditiously. So long as the law fails to provide refund protection for Section 206 complaints, the wholesale supplier will continue to have an incentive to delay these proceedings. The Regulatory Fairness Act would remedy the regulatory disadvantage that wholesale customers currently face.

I would also note that, while Section 205(e) of the Federal Power Act grants requests for rate adjustments by supplying utilities "preference over other questions pending before it (the Commission)," expeditious handling of cases that are fully litigated has been the exception, not the rule. This is because, even without discovery process problems and company-motivated delays, hearing processes at FERC take considerable time. Current law protects wholesale suppliers from this regulatory lag, but fails to provide the same protection to wholesale customers.

A great percentage of Section 205 petitions, in fact, are settled and not fully litigated. Clearly, settled cases take less time than fully litigated cases. Under current law, the supplying utility has a financial incentive to settle a Section 205 case in order to avoid or reduce any refund liability. Conversely, the company, as previously discussed, has an incentive to delay a Section 206 proceeding.

The solution is not a legislative admonishment to FERC, but a legislative change which compensates the wholesale customer for this regulatory lag and encourages the wholesale supplier to realize that its own best interest is served by seeing that Section 206 cases are concluded as expeditiously as possible. The Regulatory Fairness Act would do just that.

Question 2. You indicate that interest rates have dropped since 1984 and assert that consumers should have shared in the benefits. What about other cost factors? Couldn't these have offset the decrease in interest rates?

Just and reasonable electric rates should be designed to reflect a utility's overall operating cost. Various cost components which make up the final rate can fluctuate up or down. These include: cost of capital, taxes, fuel costs, and various construction costs, including labor and material.

It is certainly true that reductions in one cost component of electric power cost, such as the cost of capital or taxes, do not prove that a rate reduction is deserved. Increases in other costs could offset such declining costs. However, during this same time period, according to the *Handy-Whitman Index of Public Utility Construction Costs,* these other expense items that are not tracked in rates, have either not increased, not increased in the same magnitude as the offsetting decrease in the cost of capital, or have fluctuated from region to region. Further, some costs, such as decommissioning costs, are fully recoverable over time. Hence, even if rates are not immediately increased to recover such rising costs, the supplier will still receive full recovery.

I would point out, however, that the drop in interest rates was referred to primarily to make the point that changed economic conditions can, over time, render "just and reasonable" rates unjust and unreasonable. Current law forces wholesale power customers to pay these unjust and unreasonable rates during months or years of a pending Section 206 complaint, until the FERC provides some prospective relief. I believe this is inequitable and requires a change.

In general, a customer decision to file a complaint, or a Commission decision to initiate an investigation, is likely to result from a significant decrease in a major expense item that is not automatically tracked in rates. Once triggered, any FERC investigation will be comprehensive and will address all aspects of a utility's cost of service. Any offsetting increases will be provided full and appropriate consideration.

The Committee may find of interest Table 23 of the Energy Information Administration report "Financial Analysis of Investor-owned Electric Utilities" which predicts that most component costs of electricity should fall over the next decade (see attachment A).

Question 3(a). **Do you agree that the imposition of a refund obligation under Section 206 could, at least in some circumstances, threaten a utility's financial health?**

A refund obligation is clearly likely to reduce a company's revenue, but only to a level consistent with the just and reasonable standard. The FERC has consistently applied that standard so as to provide a return on prudent utility investments in a range corresponding to the financial health of the company.

Any refund ordered under Section 206 represents excess profits. Any refund ordered under this provision is unlikely to affect the financial health of a utility.

Most FERC-jurisdictional utilities have only a small portion of their revenues and earnings subject to FERC regulation. Any rate reduction would be an adjustment within this small percentage. Even for those companies that are predominantly or solely subject to FERC regulation, it is unlikely that any refund obligation would have a material adverse effect on the company's financial health.

This financial concern was put forward by the companies in arguing against inclusion of the equity reopener refund provision in the schedules of the Yankee companies (which are solely FERC-jurisdictional companies). The FERC determined that this provision would not create major financial uncertainty, nor would it affect the riskiness of an equity investment in these Yankee companies.

Only in the presence of other, major adverse factors, likely involving company mismanagement, could a refund obligation be a serious threat to a company's financial health. The House-passed bill provides FERC with sufficient discretion to waive or reduce the company's refund liability to account for such unusual circumstances.

Question 3(b). **What protection is there against such a result?**

I do not believe, as stated above, that a utility would be financially threatened as a result of the Regulatory Fairness Act. This issue was raised in the House and addressed in H.R. 2858. Specifically, the House-passed bill was amended to allow FERC, upon demonstration by the company that the refund liability would be "adverse to the public interest," to waive or reduce the refund requirement. Further, under the Hope doctrine the FERC is required in setting a just and reasonable rate to provide a return to investors "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credits and to attract capital." The Regulatory Fairness Act leaves unchanged this rate setting doctrine.

Question 4(a). **Even if these bills do not threaten a utility's financial viability, they do create additional uncertainty. That additional uncertainty will carry a risk premium and necessarily increase overall utility financing costs by some increment. Do you have any idea what the increment is?**

I do not accept the premise that these bills create additional uncertainty. Investors are not guaranteed a given revenue stream. Rather, investors anticipate that, given prudent management, a company will recover its allowable costs and a reasonable return on the investment. This legislation should leave that perception unchanged, since the underlying principle of just and reasonable rates is unaltered. Further, the risk of refunds is something that all utilities have to face. Under current state and federal regulatory practice, investor-owned utilities have been exposed to refund liabilities without that exposure exacting a risk premium.

Question 4(b). **What assurances do we have that the benefits of the Regulatory Fairness Act will outweigh the additional costs of capital experienced by utilities and ultimately consumers?**

Again, it is my belief that this legislation will not result in measurably increased capital costs and, thus, higher rates. However, even if one accepted the premise that capital costs would increase, these increases would not discount the value of this legislation. FERC, in setting a just and reasonable rate, considers the cost of capital of the regulated company. Any increase in the cost of capital will be reflected in FERC setting a higher rate of return for the supplying company. The resulting new rate will likely still be low than the rate previously in effect, despite the addition of any risk premium.

Question 5(a). **You note the provision of the House compromise that waives filing fees for rate decreases under both Section 205 and 206. What is the justification for this?**

The House provision waives filing fees only for Section 205 rate decreases. Under current regulations, fees are waived for certain Section 206 filings (18 CFR 381.108). Fees were waived for Section 205 rate decreases in an effort to create symmetry and to encourage companies to voluntarily file for rate reductions.

Question 5(b). **Don't filing fees create some threshold discouragement of frivolous filings?**

Administrative filing fees are not meant as a financial deterrent, but rather to recover certain administrative costs. Using filing fees to discourage frivolous filings could also serve as a barrier to an aggrieved party seeking just relief.

More importantly, there is no need to create an additional discouragement for frivolous filings, since a financial discouragement already exists: only those complaints that are sound, and to which the Commission agrees, receive any economic benefit (reduced rates). It is illogical for a customer to absorb the substantial costs of pursuing a Section 206 complaint that is knowingly unfounded. In those Section 206 proceedings where my agency was the sole complainant, we have incurred cost of approximately $200,000, in addition to considerable staff time.

The Commission has sufficient discretion to dismiss frivolous filings, and the House-passed bill includes several provisions to aid the Commission in identifying frivolous filings. First of all, under the House-passed bill the customer must specify, to the extent practicable, the change or changes to be made and the reasons for those changes. Secondly, the bill codifies existing case law and regulatory practice that the complainant has the "burden of going forward" -- of making a prima facie showing that the current rate is unjust and unreasonable. Combined, these two provisions make it highly unlikely that a frivolous filing will be set for hearing.

Question 5(c). **Won't the administrative costs not covered as a result of the waiver for rate decreases simply be passed on in other filing fees? Is that fair?**

Congress has required the FERC to recover 100 percent of its operating costs. In addition to charging fees for specific services, the Commission has imposed an annual assessment on the FERC-jurisdictional companies. It is assumed that the waiver in this bill will result in these annual fees being correspondingly increased.

In any event, the fees and assessments paid by the utilities are a cost of doing business at wholesale and, therefore, are recovered from the wholesale customer.

RESPONSES TO QUESTIONS OF SENATOR BUMPERS

ON THE REGULATORY FAIRNESS ACT

Question 1. It has been suggested that this bill is unnecessary as a protection for consumers from regulatory lag, since the FERC could expedite rate proceedings and thus, avoid delays. They cite FERC's swift action in the Yankee cases as evidence of the Commission's ability to expedite such proceedings and protect consumers. Do you agree that FERC could act as swiftly in all Section 206 complaints?

As stated in response to Chairman Johnston's first question, I do not believe that the problem can be corrected by prodding FERC. The prospective-only relief provided under Section 206 affords the companies the opportunity and incentive to delay. This legislation would remove that incentive, thereby encouraging more expeditious consideration of Section 206 complaints.

Moreover, while FERC acted quickly in the Yankee cases, it clearly believes that such swift action alone could not resolve the inequity endemic in the current process. Consequently, the Commission used those proceedings to reform the process through imposition of an equity reopener provision. That provision, if finally adopted, will protect a few wholesale customers from regulatory lag. This legislation provides similar protection for all wholesale customers.

Question 2. Do you agree with Mr. Berlin's testimony that enactment of this legislation -- even if no complaint is ever instituted under the amended Section 206 -- will adversely affect every FERC-regulated investor-owned utility because an increase in risk will raise the cost of capital, and thereby electric rates?

There is no reason to believe that enactment of this legislation should cause financial fall-out for investor-owned utilities. The investor is not guaranteed, nor expects, a specific revenue stream. Rather, a prudent investor anticipates that the prudently managed utility will receive a just and reasonable rate that will allow recovery of prudently incurred costs and a reasonable return on investment. The investor is aware that various factors, including regulatory action, can affect the value of the investment in either direction. These factors, if significant, are usually disclosed in the company's financial report to stockholders. A cursory review of these notations reveal financial uncertainties and potential liabilities of greater import than the likely refund liabilities resulting from this legislation. Further, the majority of these notations do not result in the company receiving a qualified financial statement.

Enactment of this legislation does not alter the regulatory bargain. Refunds will occur only when FERC finds, upon complaint or its own motion, that rates are excessive. Investors can still expect to recover the costs of prudent investments and receive a reasonable return on their investment. Any previously collected revenue returned to customers is undue profit above the just and reasonable rate. No investment strategy -- and no legitimate regulatory bargain -- should be based on a presumption of receiving such a return.

Further, investors are aware that previously collected revenue can be returned to customers, under current law, through regulatory or judicial action. For instance, state and federal regulators can and have ordered companies to refund monies when imprudent or improper costs were passed on to customers through the fuel adjustment clause.

The Maine Yankee company has faced the type of contingent refund liability Mr. Berlin discusses without suffering a material adverse effect. Maine Yankee's existing settlement in Docket No. ER84-344-001, approved by the Commission on April 15, 1985, provides that Maine Yankee's customers may file a Section 206 return on equity complaint against Maine Yankee as early as January 15, 1988, and receive any relief ordered in such a Section 206 proceeding from a January 15, 1988 effective date forward. Despite this contingent, floorless refund liability agreed to in its settlement, Maine Yankee has been operating for the past 2 1/2 years without any lender construing this contingent liability as a "material adverse change." In fact, not only did this contingent liability not result in a capital risk premium, but on April 28, 1987, Maine Yankee filed an amendment to that very same settlement which reduced the company's return on equity 190 basis points.

There is no reason to assume that enactment of this legislation, in and of itself, will raise the cost of capital for FERC-regulated investor-owned utilities.

Question 3. In your experience, are there reasonable grounds for the investor-owned utilities to anticipate that the proposed bill will be administered by FERC so as to lead to adverse impacts upon the financial ratings of investor-owned utilities?

To the contrary, I believe that the FERC has given ample consideration in past decisions to the financial condition of the investor-owned utilities. For instance, FERC policy on treatment of abandoned plants and construction work in progress (CWIP) demonstrates considerable concern with the financial condition and integrity of the private power companies. In fact, some would argue that FERC has, in the past, given greater consideration to the financial health of the companies than to the financial condition of the companies' wholesale customers.

The history of the past several years suggests that the investor-owned utilities share this perception of the FERC. Various private power companies have structured or restructured their corporate affairs to remove significant aspects of their operations from the jurisdiction of state regulatory bodies and place them under the jurisdiction of the FERC. While some of this movement may have been done for organizational or operational efficiency, it is unlikely that it would occur if FERC were viewed as being hostile to or inconsiderate of the financial condition of the investor-owned utilities.

Question 4. In your view, would this legislation expose a supplying utility to an unlimited refund liability in either the length of time of the refund obligation or the dollar amount?

No. This provision would not result in an unlimited liability in either the length of time of the refund obligation or the dollar amount.

This bill does not contemplate full restitution. Even if a customer believes that he has paid excessive rates for several years, only those overcollections made subsequent to the FERC's setting of a refund effective date can be returned to the customer. The duration of a refund liability is, thus, bound at one end by the Commission's decision to set a refund effective date, and at the other end by the completion of the proceeding. Under this legislation, both parties have an incentive to expedite the proceeding. The customer has an incentive so that it may begin to receive the benefits of any resulting rate reduction, and the supplier has an incentive so that it can reduce the duration of the refund liability.

Nor does the bill result in an unlimited refund liability in terms of revenue. All that this bill does is adjust the effective date for any FERC-ordered rate reduction. The rate that will be set is no different than that which occurs today: a just and reasonable rate.

Under existing regulatory tenets, a just and reasonable rate is deemed to consist of that which is necessary to recover prudently incurred costs and for investors to receive a reasonable return on investment. The dollar limit for any refund obligation, then, is the difference between the rate being challenged and the just and reasonable rate set by FERC.

Question 5. Do you believe that the investor-owned utilities have the ability to estimate a reasonable range in which the rate reduction, and thereby the refund, would fall?

Any rate reduction that might occur under a Section 206 proceeding represents a reestablishment of the just and reasonable rate. Since companies are able to estimate a just and reasonable rate when filing for a rate increase under Section 205, they should be able to employ the same methods to predict a downward setting of a just and reasonable rate.

Rates consist of two components: cost of service and rate of return. The companies know their own cost of service and have access to the FERC cost of service analysis and benchmark rate of return to guide their calculation of potential refund liabilities. As the process continues, additional information becomes available that further aids the company in accurately predicting a maximum refund liability.

When the complaint is filed, the complainant cites the areas of concern, giving the company a sense of what cost components are suspect. Additional language was added in the House bill to require further specificity in the complaint. Next, following the discovery process, the Commission staff and intervenors file testimony, and the parties present a specific plea for relief with corresponding quantifications.

While the FERC itself holds the ultimate responsibility of fixing a just and reasonable rate, once the testimony is filed, the company has a very clear sense of the revenue at issue.

I would also note that for those companies using cost-of-service formula rates, the calculations are made that much easier, since only one major cost component, return on equity, usually would be challenged.

Question 6(a). **Do you believe that a revenue "floor" for refunds is necessary?**

I do not believe a reasonable rationale exists for including a refund floor. As discussed in response to questions No. 4 and 5, I do not believe that any floor is necessary if the purpose is to provide the company with a quantification of its maximum refund liability, since the company is able to make such predictions. Consequently, the only "value" of a refund floor is to reduce the refund liability and allow a company to keep previously collected excess profits. I do not find that acceptable, much less necessary.

Question 6(b). **What might be the consequences of imposing such a floor?**

Any floor other than the just and reasonable rate set by FERC would be an arbitrary standard, thereby denying the customer full recovery of excessive rates paid during the pendency of the proceeding.

There can be numerous parties -- wholesale customers, consumer advocates, state commissions and FERC staff -- engaged in a Section 206 proceeding. Given the number of views presented, it is unclear how any floor would be established. It has been suggested that the FERC could set a floor at the time the matter is set for hearing, but this would place FERC in the role of deciding between the various positions, before any substantive consideration of the issues has been made. I would note that FERC plays no such role in Section 205 increases; there is no artificial limit established by the FERC on the rate increase that a company can request.

An alternate approach would be to require the complainant to state at the time the complaint is filed the specific monetary relief being sought, with such statement becoming the floor. This would place the customer at an unfair disadvantage. Much of the information necessary to make an accurate determination is not available to the customer at the time the complaint is filed, becoming available only during the discovery process. The same information on which a company bases a rate increase request should be made available to a customer in deciding an appropriate rate decrease.

Question 7. If a revenue floor is established for refunds, do you believe that the financial coverage calculation suggested by Middle South Utilities is an appropriate means of establishing a floor?

While I can appreciate the desire of Middle South Utilities to protect the solvency of a financially distressed company, I believe the amendment is not acceptable for several reasons. First of all, as drafted, the amendment shifts the burden of proof: requiring in every case that the FERC prove the negative that such financial harm would not occur before a refund could be ordered. Second, the amendment provides a company in a given financial condition an automatic out, effectively denying the Commission the opportunity to exercise its authority and obligation to weigh the relative interests of consumers and investors. Third, if adopted, the amendment could result in wholesale customers paying the price of a utility's poor financial health resulting from management decisions, market forces, or decisions of state regulators.

More importantly, I do not believe the amendment is necessary. The House-passed bill grants the FERC sufficient discretion to consider the financial condition of a company prior to ordering the refund. There is a rebuttable presumption that refunds should be ordered unless such refunds would be "adverse to the public interest," as determined under the Mobile-Sierra doctrine. This provision, which was requested by FERC, provides the Commission the authority to consider the financial condition of the company and the interests of both investors and ratepayers before ordering a refund. This financial test provision would unnecessarily take that discretion away from the Commission.

The argument advanced by Middle South Utilities ignores the financial considerations of the wholesale customer, which may be in a poor financial condition due to the excessive rates of the supplier. FERC must be allowed to exercise its statutory and constitutional responsibility of balancing the interests of both parties.

DOE/EIA-0499

Energy Information Administration
Washington, D C

Financial Analysis of Investor-Owned Electric Utilities

Attachment A

November 1986

REF.
HD
9685
.U5
F55

Table 23. Components of Electricity Prices for Investor-Owned Electric Utilities, Base Case, 1985, 1990, and 1995

(1985 Mills per Kilowatthour)

Price Component	1985	1990	1995	Percent Annual Change 1985-1995
Capital-Related				
Return on Rate Base	13.1	12.7	9.4	-3.3
Depreciation	5.7	5.8	4.4	-2.6
Federal Income Taxes	5.9	5.9	4.0	-3.8
Other Taxes	5.1	5.0	4.6	-1.0
Fuel	22.8	22.3	25.0	0.9
Operation and Maintenance	16.6	16.7	16.0	-0.4
Sales for Resale	-1.0	-0.8	-0.5	6.7
Price	68.0	67.6	62.9	-0.8

Note: In these projections, 1985 is considered a forecast year because they are based on the *1985 Annual Energy Outlook*. Since its preparation, actual 1985 data for many variables have become available.

Note: The components of price are computed by dividing each element of the revenue requirements formula by sales.

Note: Electricity prices may not equal the sum of components because of independent rounding.

Source: Energy Information Administration, National Utility Financial Statement Model, Base Case [FGMMM.D111885]

RESPONSES OF ROBERT A. O'NEIL
TO
QUESTIONS OF SENATOR JOHNSTON

Q. (1) You mentioned that investor-owned utilities ("IOU's") may compete with wholesale customers for new load. Given that electric demand seems to be growing in this country at the relatively low rate of 2 1/2 percent per year, is competition for new customers really an important consideration?

A. New load can be extremely important to any utility, and it can be particularly important to the competitive position of a cooperative. Most cooperatives serve sparsely populated rural areas, and typically have a larger amount of distribution plant investment per customer than do IOUs, which serve more densely populated urban areas. Adding load to the cooperatives' system allows the more efficient utilization of existing plant investment. Therefore, new load can be served at a small incremental cost. Of course, the specific impact -- whether beneficial or negative -- of an incremental load on any specific system is a function of the cost and operating characteristics of that system.

For this reason, national or regional growth statistics, such as the 2.5% figure mentioned in the question, have little relevance to the financial and competitive posture of an individual customer, or customer group. Of course, the proposed legislative amendment is a vehicle that would provide timely redress to specific customers or customer groups when the rates of an individual utility become excessive.

It also should be noted that regional and national growth statistics are net figures, reflecting not only new load but also the loss of existing load. Therefore, the ability to compete for new loads is important to maintaining even existing customer load levels.

Q. (2) If a wholesale customer has no generation, how can there be any legitimate competition with its utility supplier?

Are efficiencies associated with distribution systems and administration that significant?

A. If wholesale rates are priced at a level such that the wholesale customer is not discriminated against vis-a-vis the bulk power component of its suppliers retail rates, the competitive relationship between the wholesale power supplier and its wholesale customer for retail load will be governed by other factors of importance to the retail customers. For example, it may be that the wholesale customer will be able to maintain distribution efficiencies such that its delivered cost to consumers is less than the delivered cost of retail power provided by the wholesale supplier. However, the ability to provide power at an ultimate lower cost is not the entire issue.

As mentioned above, most electric cooperatives incur significant cost penalties by virtue of the fact that they are required to serve sparsely populated rural areas. However, the ownership of the cooperative, and control of its management rests with the members. Because they are customer owned, the cooperatives attempt to be extremely responsive to the needs of their member/customers. Customers may be willing to pay some price premium on retail rates in order to maintain an equity interest in their electric utility and to have a say in its management. If, however, the retail rates of the wholesale customer are inflated due to unjustifiably high purchased power rates, the economic basis upon which retail customers make decisions will be distorted. This distortion imposes a clear competitive disadvantage on the wholesale customer. The proposed legislation will mitigate the impact of such economic distortion.

Q. (3) You cite FERC's action dealing with changes in the corporate tax rate as an example of the Commission's inability to deal with major cost changes. Yet from your own description, and from everything I have heard, FERC's handling of the tax change issue seems equitable and reasonably speedy. How do you respond?

A. The limitations on the FERC's ability to order refunds when investigating rates pursuant to Section 206 raise the spectre of regulatory gridlock in the event it is required to move simultaneously against a large number of utilities. A change in tax laws or a shift in the cost of capital could create a situation where across the board rate reductions are appropriate, but under the current law, individual hearings with no interim refund relief would be required to compel those reductions. The Commission is not staffed to timely process a large number of cases.

Because of this problem, it was essential for the Commission to try to develop a method that would encourage voluntary rate filings by utilities subject to its jurisdiction. To do this, the Commission utilized a "carrot and stick" approach. The carrot was that the utilities would be allowed to lower rates for the Tax Act change only; they would not be required to adjust existing rates to recognize such other factors as reduced rate base due to additional accruals to depreciation or deferred tax reserves, and reduced capital costs.

The "carrot" approach of the Commission, increased the likelihood that the customer would get part of the rate reduction to which it would be entitled on a straight cost of service basis, but assured also that the regulated utilities would be able to retain rate levels that in all probability would be excessive if subjected to a full cost-of-service review.

The "stick" was the threat of a full blown Section 206 proceeding, in which the Commission would look not only at changes in tax rates, but also changes in load levels, depreciation reserves, deferred tax reserves, changed capital cost, etc. If the Commission had been met with large scale opposition from the industry, the viability of the "stick" approach would be extremely suspect. The Commission simply does not have the Staff to process that many cases simultaneously.

While it is true that the method adopted by the Commission did result in a relatively "speedy" response from the industry, it is not at all clear that the results are equitable. It was a compromise made necessary by the legislative inequity the proposed amendment to the Federal Power Act would rectify.

Additionally, the very existence of this pending legislation may have been an inducement to the industry to respond to the Commission's invitation to file limited rate reductions in order to avoid more substantial rate cuts after an investigation.

RESPONSES OF ROBERT A. O'NEIL
TO
QUESTIONS FROM SENATOR BUMPERS

Q. (1) It has been suggested that this bill is unnecessary as a protection for consumers from regulatory lag, since the FERC could expedite rate proceedings and thus avoid delays. They cite FERC's swift action in the Yankee cases as evidence of the Commission's ability to expedite such proceedings and protect consumers. Do you agree that FERC could act as swiftly on all Section 206 complaints?

A. No, I do not. It is important to recognize that the Yankee cases involved formula rates, and the focal point of the investigations ordered by the Commission was directed at a single component -- the equity rate of return. Many rates that might become subject to a Section 206 investigation would be predicated not on a formula, but on test year ratemaking. This would mean that it would be necessary to develop a full cost-of-service study, and for the Commission to consider issues relating to expenses, rate base offsetting reserves such as depreciation and tax reserves, cost allocation questions, etc. The "typical" case that might be subject to a Section 206 investigation would not be like the Yankee cases.

This is not to say that the Commission would be unable to expedite any Section 206 cases. If the Commission had an extraordinary case where future refunds would be inadequate to protect the clear and present danger to the consumers from the excessive rates, or the uncertainty of refund exposure would present a clear and significant adverse impact on the Company, the Commission would have the ability to act on an expedited basis. One must recognize that an expedited case involves the martialling and concentration of significant administrative resources. It is unrealistic to expect that such effort could be expended in each and every case that might develop.

Q. (2) Do you agree with Mr.Berlin's testimony that enactment of this legislation - even if no complaint is ever instituted under the amended Section 206 - will adversely affect every FERC-regulated investor-owned utility because an increase in risk will raise the cost of capital, and thereby electric rates?

A. I believe that Mr.Berlin greatly exaggerates the significance on the capital markets of the proposed amendment to the Federal Power Act. The FERC still will be required by the Federal Power Act to assure that regulated utilities are allowed an opportunity to recover their prudently incurred expenses and their cost of capital. If there is any "risk" to an investor, it will be that after passage of the amendment the ability to realize what may be characterized as "monopoly" profits will be diminished.

It is particularly important to bear in mind that apart from major statutory changes affecting costs, such as the Tax Reform Act Of 1986, the most likely circumstance under which wholesale rates may become excessive occurs several years subsequent to the addition to rate base of a major capital investment. If the underlying rates have been predicated in part upon a large plant addition, for which no depreciation or deferred tax reserves have yet been booked, the demand charge component of the rate will reflect the full carrying cost of the new, undepreciated plant. If the plant addition creates a significant amount of surplus generating capacity, the demand charge will recover the cost of that surplus capacity as well. As customer load grows to utilize that excess capacity, and rate base offsetting reserve accounts, such as depreciation reserves and deferred tax reserves, increase, the underlying rates will overrecover the costr of service. However, at this point in time the utility is not going to the capital markets. In fact, it even may be buying its equity back on the open market. If open market purchases are taking place, the customer actually suffers to the extent the utility must pay a stock premium, predicated on excessive earnings levels. Consequently, it is difficult to see how the passage of this amendment to the Federal Power Act will adversely affect the cost of capital to utilities or electric rates to consumers.

Q. (3) In your experience, are there reasonable grounds for the investor-owned utilities to anticipate that the proposed bill will be administered by FERC so as to lead to adverse impacts upon the financial ratings of IOU's?

A. No, I do not. In fact, the Commission has conducted itself in such a way as to be extremely sensitive to the financial needs of the utilities that it regulates. The Commission has adopted a future test year for ratemaking, has required the use of comprehensive interperiod tax normalization, has a plant cancellation policy that significantly insulates utilities from adverse economic consequence, has liberalized the inclusion of Construction Work In Progress in rate base, and taken many other actions intended to assure the financial well being of utilities subject to its jurisdiction.

Q. (4) In your view, would this legislation expose a supplying utility to an unlimited refund liability in either the length of time of the refund obligation or the dollar amount?

A. It is simply inaccurate to state that the utility would be subjected to an unlimited refund liability. Any attempt by the Commission to reduce rates below a just and reasonable level would be unlawful. Again, it has been judicially recognized that a utility is entitled to recover its prudently incurred expenses, including its cost of capital. Quite simply, the Commission could only require refunds of those levels of earnings that exceeded what would be deemed a just and reasonable level.

The exposure also would not be unlimited in time. The utility subject to a Section 206 investigation challenging the reasonableness of its rates has a number of options available to it, in addition to awaiting the outcome of the case on the merits. First, the utility may agree to settle the case. Many Section 205 cases are resolved through settlement because the parties are able to estimate what the outcome is likely to be, and conclude that extensive litigation is not warranted. The existence of a refund obligation diminishes the incentive to delay a resolution of the case. Second, if the utility believes that there are changed factual circumstances such that would lead it to conclude that the evidence presented in the Section 206 case did not fairly represent what its current costs were, or would be, it retains the option of filing a Section 205 case. This effectively locks in its exposure from the record developed in the pending Section 206 investigation.

Q. (5) Do you believe that the investor-owned utilities have the ability to estimate a reasonable range in which the rate reduction, and thereby the refund, would fall?

A. Investor-owned utilities frequently must estimate the impact of regulatory proceedings, as well as other forms of litigation. It is not at all unusual to see qualifications in financial statements noting refund exposure, nor is it unusual for utilities to set aside reserves to cover such a deferred liability.

Q. (6) Do you believe that a revenue "floor" for refunds is necessary? What might be the consequence of imposing such a floor?

A. As discussed in response to the questions posed above, I believe the exposure of an investor-owned utility to a refund obligation is greatly exaggerated. But if a floor were established, there are several potential consequences that should be borne in mind. It is only after discovery that the customer and the Commission will have the information necessary to determine the level by which the existing rate is excessive, and hence the likely refund exposure. If a refund floor is selected without regard to factual data, in all probability the level selected will be too high or too low. If the floor is set too high, the utility will be allowed to retain unjust and unreasonable profits. If the floor is set too low, it might create the impression of a refund exposure that in fact is not realistic.

Q. (7) If a revenue floor is established for refunds, do you believe that the financial coverage calculation suggested by Middle South Utilities in an appropriate means for establishing a floor?

A. I believe that the refund floor proposal submitted by Middle South is unnecessary. There is no reason why the wholesale customers should be denied refunds otherwise due them because the bond ratings of a utility might be adversely affected as a result of company mismanagement, state regulation, exposure as a result of nonutility operations, or other factors unrelated to the provision of wholesale service. In any event, the FERC retains the discretion to shape the amount and timing of payment refunds in a manner consistent with the public interest. In appropriate circumstances, the Commission may defer the payment of refunds, or amortize them over some period of time consistent with what the public interest dictates.

DEC 16 1987

STATE OF ILLINOIS
OFFICE OF PUBLIC COUNSEL
205 West Randolph, Suite 930
Chicago, Illinois 60606

STEPHEN J. MOORE
PUBLIC COUNSEL

TELEPHONE:
(312) 793-1600

December 15, 1987

The Honorable J. Bennett Johnston
Chairman
United States Senate Committee on Energy
  and Natural Resources
Washington, D.C. 20510-6150

Re: Regulatory Fairness Act, S.1567 and H.R. 2858

Dear Senator Johnston:

Enclosed is the response to the questions you sent to me on December 3, 1987. Thank you for giving me the opportunity to speak to the Committee on Energy and Natural Resources. I hope that testimony and these responses assist the Committee in its decision on this bill.

Very truly yours,

Stephen J. Moore
Public Counsel

SJM:sf
Enclosure

1. DO YOU HAVE ANY REASON TO BELIEVE THAT THE FERC'S PLAN FOR DEALING WITH CORPORATE TAX CHANGES IS NOT WORKING?

The FERC's experience with passing on to ratepayers the benefits of the Tax Reform Act of 1986 is a perfect example of the need for the Regulatory Fairness Act. On June 26, 1987 the FERC issued Order 475 requesting that the 150 wholesale suppliers subject to its jurisdiction reduce their rates to reflect their lower tax expenses. Utilities were to file these lower tariffs alphabetically, from September 15, 1987 to November 30, 1987. Due to the FERC's perception of its authority, compliance with the order was made voluntary. The FERC encouraged compliance by threatening to institute Section 206 rate reductions against those utilities that failed to voluntarily lower their rates.

The deadline for the filing of voluntary reductions has now passed. The FERC has informed the Office of Public Counsel that as of December 10, 1987, 44 of the 150 utilities subject to FERC jurisdiction have filed tariffs reducing their rates. Some of the remaining 106 utilities have already raised or lowered their rates in 1987 and have therefore reflected the new tax rate in their tariffs. But FERC will need to investigate the rates of the other utilities, and, file Section 206 proceeding against those it determines are earning more than a just and reasonable return. Until it enters orders in those investigations, those utilities will continue to charge rates based on the old 46% statutory tax rate. Under the current Federal Power Act, the rate reductions that will result from those investigations will be prospective from the date of those orders. No refunds will be available.

If the Regulatory Fairness Act had been in place this year, the customers of the wholesale suppliers subject to the FERC's jurisdiction would have benefited in four ways. First, the FERC would have been able to order refunds in the Section 206 cases it initiates. Customers would thus receive rate reductions from the recalcitrant utilities earlier than they will receive under current law.

Second, the rate decreases in these FERC initiated Section 206 proceeding will be greater with enactment of the Regulatory Fairness Act. This will occur because the ability to order refunds will eliminate the incentive to dispose of cases quickly by ignoring some issues. Under the current law, the FERC will feel compelled to conduct an abbreviated analysis of each utility's costs and revenues so that it may reduce rates as soon as possible. On the other hand, if the FERC could order refunds, it would be able to conduct thorough analysis of those utilities and pass on to ratepayers the benefits of those analyses. To put it simply, time would no longer be on the side of the utilities.

Third, because the FERC's threat to institute Section 206 investigations would have included the possibility of refunds, it is likely that more than 44 utilities would have made voluntary rate reductions. Some utilities realize that the FERC ordered decreases in Section 206 investigations may exceed their tax savings. For example, some utilities, rates are based on high costs of capital established during periods of high inflation. Although they were willing to accept the risk that the FERC will lower rates to reflect tax savings and lower cots of capital under the current Federal Power Act, they may not have wanted to do so if FERC had the authority to order refunds.

Fourth, the inability to obtain refunds has undoubtedly inhibited purchasers of wholesale power from initiating their own Section 206 complaints. Those complaints could have been filed as early as the date of the passage of the Tax Reform Act in October, 1986.

In conclusion, the FERC's plan for dealing will the reduction of the maximum corporate tax rate makes the best of a bad situation. The FERC has taken every action it believes to be within its authority. The FERC is not the problem. The Federal Power Act is the problem. Granting the FERC the ability to order refunds of excessive rates paid during the pendency of Section 206 proceedings will accelerate the pass through of tax savings to wholesale power customers and allow it to set rates that account for all factors that have lowered utilities' costs.

2. YOU WOULD AGREE WOULDN'T YOU THAT THERE WILL BE SOME INCREASE IN THE COST OF CAPITAL TO UTILITIES IF THE REGULATORY FAIRNESS ACT IS ENACTED?

Enactment of the Regulatory Fairness Act, as amended and adopted by the House of Representatives, would not increase the cost of capital to utilities. First, the potential for refunds would be a minor factor in investors' evaluations of utilities's risks. The prices of debt capital and equity capital are set by market supply and demand for capital inputs, and both are influenced by the relationship between the risk and return expected for those securities and the risks expected from the overall menu of available securities. Additionally, capital investment is generally a long term proposition. Debt and equity investors are therefore more interested in the long term earning prospects of a utility than its liability for refunds of past excessive earnings.

Second, investors can easily identify the portion of a utility's earnings subject to refund. Federal Power Act section 206 complaints, as contemplated under the amended Regulatory Fairness Act, are constrained by the standard of reasonableness which requires identification of specific, substantiated refund claims. Actual earnings in excess of reasonable returns are clearly quantifiable, both in terms of duration and magnitude. Since the initial burden of proof is on the complaintant, allegations of earnings in excess of the cost of doing business must be substantiated by *prima facie* evidence that identifies the basis for and extent of refund claims. The rights and duties of the complaint process, as embodied by the amended bill, creates no more uncertainty than that faced by investors in evaluating the effect of weather on utilities' revenues.

Third, the amended bill allows the FERC to consider the effect of a refund on the financial viability of a utility. It is inconceivable that refunds would be ordered that would impair a utility's capital flexibility or result in the abrogation of indenture restrictions and coverage ratios appropriate to the construction mode of the utility. Such action is clearly not in the public interest, a refund standard which can not be legally violated.

Finally, the experience with "risk reducing" procedures of the FERC demonstrates that investors will pay little attention to the potential for refunds. For example, regulation that has diminished regulatory risk has not resulted in lower industry wide or utility specific cost of capital. F.E.R.C.'s allowance of construction work in progress in rate base (Docket RM 86-6-000; Order No. 474) has increased utility internal cash flow, but has not tangibly decreased the cost of capital. The yawn heard from investors is not surprising. Investor perception of the risk associated with utility securities is based on a continually changing mix of business, financial, and regulatory factors. Simply allowing a procedure whereby wholesale rates may be subject to refund from the date set by the FERC will not skew the weight investors attach to the regulatory risk premium.

2a. ARE YOU CONFIDENT THAT THE BENEFITS TO CONSUMERS OUTWEIGHT THESE COSTS?

As discussed above, enactment of the Regulatory Fairness Act will not raise utilities' costs of capital. Opponents of the bill have only been able to raise nebulous claims regarding such costs. In contrast, the benefits to customers are clear and identifiable.

Consumers benefit from the Regulatory Fairness Act by having the legal opportunity to recoup revenues materially in excess of the rate of return necessary to enable the utility to maintain its credit and attract capital in accordance with the standards of the Bluefield decision. Because regulatory responses to changing financial and operating environments are necessarily time-consuming does not justify the consumer forfeiture to the right to reclaim excess earnings.

Consumers, as well as investors, attach a time value to cash flow. Refunded revenues, reflect the opportunity cost of funds that consumers would have foregone with only prospective rate relief. Refunded revenues also represent an infusion of capital into local economies where it can be put to more productive uses. Greater supplies of capital in the marketplace encourage capital cost reduction, not increases.

Consumers may also benefit in less tangible ways. The fact that past revenue flows are contestable creates an additional corporate incentive to adopt least-cost financing and operating strategies. Furthermore, refund liability encourages negotiations among parties to mitigate an unfavorable outcome to a contested proceeding.

2b. DO YOU HAVE ANY EMPIRICAL SUPPORT FOR YOUR JUDGEMENT?

This question should actually be directed at the opponents of the bill. Can they demonstrate that, from the perspective of customers, the incremental costs of capital outweight the benefits of refunds? They will not be able to do so.

From an empirical standpoint, there are many methods for computing the cost of capital based on macroeconomic influences. No method could capture and precisely identify the isolated affect the Regulatory Fairness Act may have on a utility's cost of capital. It is clear, however, that regulatory mechanisms that seek to lower regulatory risk, such as the adoption of forward test years, automatic fuel adjustment clauses, and the inclusion of construction work in progress, have not been translated into lower capital costs. Conversely, there is no reason to believe that creating a right to claim a date specific refund will contribute to the costs of capital. Interest rates and the risk adjusted supply and demand for capital represent the major explanatory factors in the determination of the cost of capital.

WALKER F. NOLAN, Vice President, Legislative Affairs

EDISON ELECTRIC INSTITUTE The association of electric companies

1111 19th Street, N.W.
Washington, D.C. 20036-3691
Tel. (202) 778-6400

December 17, 1987

The Honorable Bennett Johnston
United States Senate
Washington, DC 20510

Dear Senator Johnston:

Enclosed are responses to the questions posed by you and Senator Bumpers regarding the Regulatory Fairness legislation, S. 1567 and H.R. 2858. These questions were addressed to Rodney Mundy, who represented the Edison Electric Institute at the hearing on these bills. The accounting firm of Deloitte Haskins and Sells has prepared a report on the potential impact of the legislation on utility financial statements and auditors' opinions. A copy of the letter is enclosed, and I request that it be made part of the hearing record.

EEI would be happy to provide additional information regarding the potential impact of this legislation, at the request of the Committee.

Sincerely,

Walker

Walker F. Nolan

Questions of Senator Johnston

1. What incentive does a utility really have to file for a rate decrease under Section 205 when costs come down? Isn't it true that in such a situation, profitability is increased as long as the rate remains in effect? What incentives are there under current law for utilities to settle meritorious Section 206 complaints? Since relief is only prospective, isn't it in a utility's best interest to ensure protracted proceedings?

Answer:

Some background is necessary to respond properly to this series of questions. FERC's obligation, in a Section 206 proceeding, is to "determine the just and reasonable rate ... to be thereafter observed and in force, and (to) fix the same by order." Judicial interpretation over several decades has made it clear that there is a broad zone of reasonableness and if FERC establishes a rate which falls anywhere within the zone, it will not be disturbed. Therefore, there is no one just and reasonable rate in any given situation; reasonableness is more accurately defined as a zone, not a point. Further, a just and reasonable rate is established by expert evidence, and there is often very wide disagreement among the experts. This disagreement is especially evident in the area of return on equity capital (ROE). Disagreements of 500-600 basis points among the experts in a rate case is not uncommon. The determination of a proper ROE is by nature subjective and, thus, absolute precision in establishing rates cannot be obtained. It follows that a given Section 206 claim cannot be objectively denominated "meritorious" due to the subjective nature of the inquiry and the broad range of the "zone of reasonableness." It is the duty of the regulatory body to monitor utility rates to ensure that they are within the zone of reasonableness.

Utilities do voluntarily file rate decreases under Section 205 of the Federal Power Act. I mentioned in my testimony that Alabama Power Company recently negotiated a substantial rate decrease with its municipal customers and filed this decrease under Section 205. Further, Alabama Power Company and the other subsidiaries of The Southern Company filed reductions in the ROE component of numerous formula rates under which they sell electric power to non-associated utilities. Utilities have incentives to file for rate reductions when justified by reductions in cost of providing the service. Among the incentives is the necessity of maintaining good relations with their customers, policymakers and regulators. Furthermore, incentives exist in the form of competition with other sources of energy. Many customers, especially industrial customers, have the options of self-generating, cogenerating and locating facilities in other geographic areas where rates are lower. In addition, by filing a rate reduction under Section 205, a utility is able to avoid the great expense of a protracted proceeding and the resulting drain on management's time and energy.

The full weight of regulatory power can be brought to bear on a utility that refuses to act reasonably to reduce rates. I believe that it is naive for anyone to assume that FERC does not have adequate regulatory clout to prompt utilities to reduce rates when circumstances warrant it.

Although a utility's "profitability" would often be increased by retaining higher rates, rather then lower rates, this is not always true. If lower rates stimulate additional sales, then the lower rates could produce higher profits. This can occur in bulk power markets where there is competition for coordination type services.

Incentives always exist for any party to any rate proceeding to settle issues or the entire case. Settlement saves time, effort and money; it eliminates uncertainty which might otherwise exist for years; it secures for each party at least some of what that party is seeking, obviating the very real risk that such party will receive less favorable treatment from the regulator. Thus, it is not surprising that most parties to a proceeding are ready and willing to settle, and that a very large majority of electric rate cases before FERC are settled in whole or in part.

2. You make the point that FERC has expeditiously dealt with major industry-wide cost changes such as lowered tax rates. What about utility-specific cost changes? Would you argue that wholesale customers can get relief from regulatory lag in the latter context?

Answer:

In recent years electric utilities have experienced cost decreases in two main categories: (1) cost of capital; and (2) cost of fuel. FERC handles the first situation when a utility does not voluntarily file, in an individual Section 206 case. The second cost reduction is usually passed immediately through to the customer through the wholesale supplier's fuel clause. As pointed out, the Section 206 ROE cases have been processed swiftly, taking in some instances, a period of six months to complete. Thus, I believe that wholesale customers are being protected against so-called regulatory lag.

3. You seem to rest your argument against S. 1567 and H.R. 2858 on the uncertainty that would be created by the Regulatory Fairness Act. However, you would admit wouldn't you that considerable uncertainty exists now under Section 206?

   At present, when a wholesale customer files a 206 complaint the utility is faced with the possibility that its wholesale rates may be lowered in the future. That is a fairly large uncertainty isn't it?

   The bills before us generally make a future rate decrease effective from the filing of a complaint. That may be additional uncertainty, but it is qualitatively different from what a utility faces now?

Answer:

Like any scheme of regulation, the Federal Power Act balances the risks imposed upon wholesale suppliers. As the questions point out, the quantum of risk inherent in the Act includes certain risks related to Section 206 complaints. However, these risks are known, and have been the same for over fifty years. Like other risks, they have been taken into account by investors in determining the return that is required before making an investment in the securities of a utility.

S. 1567 and H.R. 2858 would substantially increase the uncertainty, and thereby the risk, of an investment in an electric utility with substantial wholesale sales. The refund provision of the legislation would increase utility risk because revenues collected under just and reasonable rates, and which the utility may have spent, could be subject to refund. The effect will vary from utility to utility. It will, of course, be greatest for utilities wholly regulated by FERC. As the risk increases so will the cost of capital.

4. You refer in your testimony to the coverage requirements that are typically included in first mortgage bond indentures. Have you done any actual review of such provisions and whether the bills before us would trigger their restrictions? If not, would you do so and submit your analysis for the record?

Answer:

Earnings coverage requirements are incorporated in first mortgage indentures and corporate charters of electric utilities. The Securities and Exchange Commission (SEC) acting under the Public Utility Holding Company Act of 1935, has issued guidelines for earnings coverage provisions to be incorporated in first mortgage indentures and charters of utilities which are subject to its jurisdiction. Those requirements are set out in Holding Company Act Release No. 13,105 dated February 16, 1956 and Holding Company Act Release No. 13,106 dated February 16, 1956. Fed. Secr. L. Rep. (CCH), paragraphs 36,675 and 36,691 (1956). Although these guidelines are mandatory only applicable for holding companies, they are in general use by the electric utility industry generally.

Under these guidelines, a first mortgage bond indenture would typically require, before the issuance of any additional bonds, that earnings be 2.0 times the interest on all outstanding bonds plus the interest on the bonds proposed to be issued. In making this calculation, a recent 12-month period must be selected in accordance with the requirements of the earnings coverage provision. Earnings coverage requirements usually restrict the amount of non-operating revenues which can be included in the coverage calculation. There has been a substantial question in past years as to whether revenues subject to refund can be included in the calculation of 2.0 times requirement. No definitive ruling has ever been made on the matter.

The consequences of this for a utility with a substantial portion of its revenues subject to FERC jurisdiction, would therefore be that an unlimited refund liability could become a determining factor in whether securities may be issued. These questions can best be addressed by the accountants and financial experts who may appear before the Committee in additional hearings.

Questions of Senator Bumpers

1. What other risks do the companies you represent currently face? What is the nature of those risks, and the impact of those risks on the financial condition of the company?

Answer:

Vertically integrated electric utilities generally face the same business and financial risks as are faced by other industrial and commercial enterprises. Because of their traditional natural monopoly position, it is generally thought that electric utilities are not subject to the same degree of competition as that experienced by most other industrial enterprises. Electric utilities are being confronted, however, with increasing competition from a variety of sources and entities, even as they continue to face pervasive regulation.

2. Do the companies you represent ever find it necessary to file notes to their financial statements that have potential financial impact? If so, how often and what is the stated extent of the potential impact? How often do these notes result in qualified financial statements?

Answer:

All major electric utilities are required to include extensive notes to their audited financial statements. These notes range from a summary of significant accounting policies to detailed descriptions of on-going rate proceedings before state and federal agencies. The notes would typically include a description of significant litigation and other risks facing the electric utility. The auditors, based upon their knowledge and evaluation of the utility together with representatives of management, determine whether or not to qualify their opinion on a utility's financial statements. The standards observed by auditors in determining whether or not to qualify their opinions are generally established by the Financial Accounting Standards Board. Generally companies that have received qualified opinions from their auditors have lower than average bond ratings, and therefore higher cost of capital. These higher costs of capital would be reflected in utility rates.

It should be noted that a number of electric utilities have received qualified auditor's opinions that are the direct result of uncertainties related to the regulatory process and the difficulty of some electric utilities obtaining adequate and timely rate increases. As this Committee may hold an additional hearing on the financial and accounting impacts of the Regulatory Fairness Act, these questions could be addressed more fully by the accountants presenting testimony at such hearings.

3. If a company faced a refund liability pursuant to S. 1567 or H.R. 2858, could this be similarly noted in its financial statement?

Answer:

Yes. Not only could such a refund liability be noted, it is likely that management would be required to note and disclose any significant refund liability.

4. If the utilities earn in excess of the allowed rate of return, do the shareholders or the customers receive the excess dollars earned?

Answer:

The term "allowed rate of return" is not fully descriptive of the ratemaking process. Generally, a regulatory body establishes a rate (cost per unit of service) to be charged by the utility until such time as that rate is changed by a filing of the utility or action of the regulatory commission. This "filed" rate is the only legal rate and the utility is prohibited from charging any other rate. In return, under the Federal Power Act, the utility is assured that all revenues collected pursuant to the established rates are "good" and not subject to reparations. In establishing the rate, one of the many factors to be examined by the regulatory body is the rate of return on common equity capital. This rate of return will vary from time to time (both up and down) during the future period when the established rate is in force. This does not mean, however, that the utility's rates are unjust or unreasonable, for there is a broad range of reasonableness in which the utility's rates are allowed to fluctuate.

A rule of general applicability in regulatory jurisprudence is that ratemaking should not be retroactive. Generally, this rule prohibits changes to prospective rates to account for past events. Rates cannot be changed to apply to prior earnings whether they are later deemed excessive or deficient.

5. Under Section 205 proceedings in which the company seeks an increase in rates, do investor-owned utilities generally put money into an escrow fund? Provide specific examples.

Answer:

While utilities generally do not separate such revenues into a special escrow fund, they do recognize the potential liability which could be incurred should they be required to make a refund. Also, utilities recognize the potential for refund in their financial planning.

Several states do require the posting of performance or supersedes bonds to assure the repayment of revenues collected subject to refund.

6. (a) Please explain further what is meant by "coverage requirements".

Answer:

Earnings coverage requirements are incorporated in first mortgage indentures and corporate charters of electric utilities. The Securities and Exchange Commission acting under the Public Utility Holding Company Act of 1935 has issued guidelines for earnings coverage provisions to be incorporated in first mortgage indentures and charters of utilities which are subject to its jurisdiction. Those requirements are set out in Holding Company Act Release NO. 13,105 dated February 16, 1956 and Holding Company Act Release No. 13,106 dated February 16, 1956. Fed. Secr. L. Rep. (CCH) paragraphs 36,675 and 36,681 (1956). For example, a first mortgage bond indenture would typically require, before the issuance of any additional bonds, that earnings be 2.0 times the interest on all outstanding bonds plus the interest on the bonds proposed to be issued. In making this calculation, a recent 12-month period must be selected in accordance with the requirement of the earnings coverage provision. Earnings coverage requirements usually restrict the amount of non-operating revenues which can be included in the coverage calculation. There has been a substantial question in past years as to whether revenues subject to refund can be included in the calculation of the 2.0 times requirement.

(b) Under Section 206 in present law can FERC set a "just and reasonable rate" that would deny a utility the revenues needed to meet its "coverage requirements." Under what circumstances could this occur?

Answer:

Under the Federal Power Act and the U.S. Constitution, FERC is required to set rates that allow a utility a reasonable opportunity to earn a fair return on its prudent investment. In doing so the FERC considers a number of factors, all of which may affect directly or indirectly a company's "coverage requirements". The level of investment upon which a company is allowed to earn a return is one factor. An example of where FERC rate setting may prevent a utility from meeting its "coverage requirement" is demonstrated by the fact that a number of utilities have been unable to obtain adequate and timely rate increases at the state level. So-called "prudence reviews" conducted by many state commissions are resulting in the reduction of utility rates to a level which precludes financing. Under the "prudence review," utilities are being subjected to disallowances of capital invested in plant because retrospectively, it is claimed that the utilities acted imprudently.

(c) If not, are there circumstances under which simply the addition of a refund liability to a reduction in rates would deny a utility the revenues needed to meet its coverage requirements? Could the refund liability be the only determining factor in this revenue calculation? If so, how does the addition of a potential refund liability affect the coverage requirement test?

Answer:

For a utility with a substantial portion of its revenues subject to the jurisdiction of the Federal Energy Regulatory Commission, unspecified refund liability could be a determining factor in the calculations required under a utility's first mortgage indenture or charter. If the accountants or attorneys who are required to render opinions with respect to the issuance of additional securities are unable to conclude that the revenues are appropriate for inclusion in the coverage calculation, the utility might be placed in the posture of being unable to finance. Again, these questions can probably best be addressed by the accountants and financial experts who may appear before the Committee in additional hearings.

Deloitte Haskins Sells

Suite 350
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2505
(202) 879-5600
ITT Telex: 4995732

Edison Electric Institute
1111 Nineteenth Street, N.W.
Washington, D.C. 20036

December 18, 1987

Dear Sirs:

You have engaged us to report on the potential impact the proposed legislation described below may have on the financial statements and related auditors' opinion of a public utility subject to Section 206 filings under the Federal Power Act. This report is being issued to assist you in evaluating the potential effects on financial statements of a public utility and related auditors' opinion that may result from the lack of a definitive limit on the amount of refunds of FERC jurisdictional revenues that might be ordered as a result of Rule 206 proceedings. Our engagement has been conducted in accordance with applicable standards established by the American Institute of Certified Public Accountants.

Description of the Proposed Legislation

The proposed legislation, entitled the "Regulatory Fairness Act," (H.R. 2858, S. 1567) would amend Section 206 of the Federal Power Act such that the Federal Energy Regulatory Commission (FERC) would be required to establish a "refund effective date" for any proceeding based on a rate refund request filed pursuant to Section 206. Any subsequent refund ordered by the FERC, based on that proceeding, would be retroactive to that date. The "refund effective date" would be required to be "not earlier than...60 days after filing" of a Section 206 complaint and not "later than 5 months after the expiration of such 60-day period."

As passed by the House, H.R. 2858 also sets forth the necessary elements of a complaint or Commission-initiated motion under Section 206. The complaint must "state plainly, to the extent practicable, the change or changes to be made in the rate, charge, classification, rule, regulation, practice, or contract then in force, and the reasons for any proposed change or changes therein." You have indicated that counsel has informally advised you that all FERC jurisdictional revenues subject to the Rule 206 proceeding accrued subsequent to the refund effective date would be subject to refund pending a final decision by FERC.

Accounting Considerations

The recognition of revenues subject to refund requires a utility's management and its auditors to assess, among other things, the likelihood that a refund will ultimately be ordered. If such a refund is at least reasonably possible, management must also assess whether there is at least a reasonable possibility that the ultimate refund will be material. (Accounting literature defines the term "reasonably possible" as when "the chance of the future event or events occurring is more than remote but less than likely.")

The assessments described above must take into consideration a variety of factors, such as the historical experience of the entity in past FERC proceedings, recent decisions by FERC relating to other utilities, and discussions with legal counsel and other individuals familiar with the proceedings. These factors provide a basis for management to indentify and quantify the potential issues on which a refund might ultimately be ordered and evaluate how the FERC will ultimately rule on such issues. Given the variety and complexity of issues confronting utilities today, it may be difficult in some instances for management of utilities with material amounts of FERC jurisdictional revenues to conclude that the likelihood of a material refund being ordered is remote.

If management does conclude that the likelihood of a material refund is "reasonably possible" (as defined above), paragraph 10 of Statement of Financial Accounting Standards (SFAS) No. 5, "Accounting for Contingencies" would apply. Paragraph 10 requires that:

> If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 [i.e., a material refund is likely to be ordered and the amount can be reasonably estimated] are not met, ... disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss ... may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible range of loss or state that such an estimate cannot be made.

Accordingly, if management concludes that it is reasonably possible that a material refund will be made, the utility would continue to record such revenues in its income statement and disclose the amount of revenues accrued from the refund effective date subject to refund and the potential range of the refund, if determinable. Such disclosures would be made in the footnotes to the financial statements in accordance with SFAS No. 5.

If management believes it is probable a refund will be ordered (SFAS No. 5 defines "probable" as those instances when "the future event or events are likely to occur") and the refund could reasonably be estimated, the utility would be required to record the loss due to refunds. In addition, the enterprise would discontinue recording as revenue the portion of amounts currently being accrued that management estimates will ultimately be refunded to customers. If management believes it is probable a refund will be ordered, but cannot reasonably estimate the amount, it will apply Paragraph 10 of SFAS No. 5 described above.

Auditing Considerations

Auditing Interpretation No. 3, "Reporting on Loss Contingencies," of Statement on Auditing Standards No. 2, "Reports on Audited Financial Statements," states, in part:

> When a future event or events that will resolve an existing contingency are reasonably possible (chance of occurrence is more than remote but less than likely) and the amount of the potential liability cannot be estimated, the auditor might modify his opinion if he concludes the potential effect of the resolution of the uncertainty is material. When the events that will resolve a contingency are probable (likely to occur), but the amount of the loss cannot be estimated, an uncertainty exists. In this case, the auditor should modify his opinion when he believes that the resolution of the uncertainty will have material effect on the financial statements he is examining.

This Interpretation requires the auditor of financial statements of a regulated enterprise currently accruing revenues subject to refund to assess the likelihood that a refund will be required. If such a refund is reasonably possible, the auditor must also assess the likelihood that the ultimate refund required for those revenues recorded will be material. If a material refund of recorded revenues is reasonably possible, the auditor would likely modify his report. If a refund is probable, the auditor would be required to modify his opinion if he believes that the refund would have a material effect on the financial statements. If the auditor qualifies his report, he would indicate that, in his opinion, subject to the effects on the financial statements of such adjustments, if any, as would have been required had the outcome of the uncertainty involving the revenues subject to refund been known, the financial statements present fairly the utility's financial position and results of operations.

The assessment of the likelihood that a potential refund could be material requires the auditor to make a judgment based on the specific facts and circumstances known to him. Such facts and circumstances are similar to those used by management in making its assessment as to the likelihood and potential amount of a refund. As noted previously, the variety and complexity of issues confronting utilities may in some circumstances make it difficult for management of a utility with a material amount of FERC jurisdictional revenues to conclude that the likelihood of a material refund being ordered is remote. If management is unable to conclude that the likelihood of a material refund is remote, it is not likely that the utility's auditor would be able to draw such a conclusion. As described above, the auditor would likely modify his report in such circumstances.

Conclusion

We cannot predict the extent to which the enactment of this legislation would result in situations where management and its auditors would assess potential refunds as material and as having a reasonable possibility of occurring. We do believe it is likely some such situations would occur. Assuming such situations would occur if the legislation were enacted, we believe the number of qualified auditors' opinions on the financial statements of utilities subject to FERC regulation would increase. In addition, even without the negative implications of qualified opinions, the additional time and effort on the part of management and auditors in making the necessary assessments described previously will result in additional costs that ratepayers must ultimately bear.

* * *

The ultimate responsibility for the decision on the appropriate application of generally accepted accounting principles for an actual transaction rests with the preparers of financial statements (i.e., management of the utility), who should consult with their continuing accountants. Likewise, the responsibility for the decision on the appropriate application of generally accepted auditing standards rests with the continuing accountants of the reporting entity. Our judgement on the appropriate application of generally accepted accounting principles and of generally accepted auditing standards for the described circumstances arising from the proposed legislation is based solely on the facts provided to us as described above; should the legislation adopted differ from that described above, our conclusions may change.

Yours truly,

Deloitte Haskins + Sells

MIDDLE SOUTH UTILITIES, INC/BOX 61005/NEW ORLEANS LA 70161/(504) 529-5262

JERRY D. JACKSON
SENIOR VICE PRESIDENT-SYSTEM EXECUTIVE
LEGAL AND EXTERNAL AFFAIRS

January 4, 1988

The Honorable J. Bennett Johnston
Chairman
United States Senate Committee on
Energy and Natural Resources
Washington, DC 20510-6150

Dear Senator Johnston:

As you requested, attached you will find responses to the questions submitted by Committee members regarding my testimony at the Committee's hearing on November 18, 1987.

Please let me know if I can be of any further assistance.

Sincerely,

Jerry D. Jackson

Jerry D. Jackson

JDJ/lr
attachment

Questions of Senator Johnston for Mr. Jackson

1. You point out that a customer can make an enormous part of your revenues subject to refund through the filing of a complaint. First, you would agree wouldn't you that actual refund is dependent upon the complaint being successful? Second, why is this uncertainty so much different from the uncertainty that can arise right now? Under existing law a customer can make an enormous part of your revenues subject to decrease in the future through the filing of a complaint. That is a fair degree of uncertainty isn't it?

A. It is true that even under S.1567 any actual refund is dependent upon a determination after a hearing that the complaint was at least partially meritorious. It is also true that under existing law (Section 206) a customer can make an enormous part of an electric company's wholesale revenues subject to decrease prospectively from the date of an order of the Commission finding that the company's rates should be decreased. Either under S.1567 or Section 206 as it now stands, you are correct that this can cause a fair degree of uncertainty. However, S.1567 or H.R. 2858, as passed by the House, would create additional uncertainty, which is much more threatening than the existing uncertainty. Under S.1567 or H.R. 2858, revenues already booked by a company pursuant to a lawful rate previously authorized by FERC would be subject to refund as well as the lowering of revenues in the future. The uncertainty caused by the ability of regulators to take away, as the result of an "after-the-fact" review, revenues previously found lawful means that investors could not fully rely on the utility's stated revenues at the time of a financing even though the utility has an order from FERC stating that its wholesale revenues are just and reasonable. The statement of John W. Barr on behalf of Morgan Stanley & Co. discusses this point, so I will not elaborate. But let me emphasize that this additional uncertainty is much different and more difficult to deal with than the existing uncertainty. I believe you should recognize also that this form of uncertainty would become a staggering problem should states adopt similar legislation making state-regulated revenues subject to refund under a complaint procedure.

2. You cite an example from your own experience in which no refunding condition was necessary to produce prompt settlement of a Section 206 proceeding. Do you mean to imply that such prompt settlements are invariably, or even generally, the result under Section 206 as it now stands?

What incentive is there under current law for utilities to settle meritorious Section 206 complaints? Since relief is only prospective, isn't it in a utilities best interest to ensure protracted proceedings?

A. Under Section 206, some settlements are handled promptly and some are not. I would point out, however, that the proponents of S.1567, it seems to me, should carry the burden of proof considering the longevity of the existing balance between Sections 205 and 206 of the Federal Power Act. Although I have not done an independent study of the time periods applicable to the average 206 proceeding, the time periods introduced by the FERC in this proceeding for the average length of time to resolve complaint cases apparently involve proceedings other than rate proceedings and for that reason, may not be relevant to this issue. From talking to attorneys who practice before FERC routinely, I have the impression that complaint cases now move much more rapidly than they once did. Moreover, a number of questions need to be addressed with respect to the FERC's figures: 1) Are the FERC's figures biased by unusual complaint cases which involve complex non-rate issues?; 2) Are they biased by older cases which no longer represent the norm; 3) Do the FERC's figures include settled complaint cases or only those which are litigated to the end?; and 4) Moreover, in each case considered in the study, how long did the case rest with the Commission itself as opposed to being in the hands of the litigants? Surely it is unfair to draw the conclusion from the FERC's figures that electric utilities drag out complaint cases if, in fact, the length of time to conclusion reflects a great deal of time given to Commission deliberation rather than discovery or pre-trial and briefing procedures. I do not believe that electric companies subject to FERC's jurisdiction and their investors should be put at risk if the reason for inordinate delay in prosecuting complaint cases lies more with FERC's internal procedures than it does with litigating tactics. Certainly, I can say that the Middle South companies have never engaged in dilatory tactics in their FERC complaint cases.

I cannot speak for all utilities, but in response to the concern you expressed, we do not consider it to be in our best interest to ensure protracted complaint cases, and we do believe there are incentives to settle Section 206 complaint cases even where a case may not be as meritorious as the complaining party thinks it is. Two major incentives are to minimize the cost of litigation and to remove the uncertainty of an unfavorable result.

Finally, I would point out that even if no incentives existed at all to settle "meritorious Section 206 complaints", it does not follow that the proposed legislation is necessary. If the FERC's preliminary judgment is that a complaint case may be meritorious, it could impose strict and expedited trial procedures on the parties such that, if the Commission itself does not take too long, a decision could be reached with seven months - the normal period of time before a Section 205 rate increase goes into effect assuming maximum suspension.

3. Do you assert that the cost of additional uncertainty represented by S.1567 or H.R. 2858 outweighs the benefits to consumers of refunds under Section 206? If so, do you have any empirical data to support that judgment?

A. Yes, it is my opinion that the cost of additional uncertainty represented by S.1567 or H.R. 2858 far outweighs the benefits to consumers of possible refunds under Section 206. See John Barr's statement on behalf of Morgan Stanley and Co., Incorporated for a further explanation of this matter.

I have not accumulated empirical data to support my judgment primarily because it seems sufficient to point out that the proponents of the legislation have not provided empirical support for their assertions. I think it highly probable, however, that if a study, covering any reasonably long and representative period of time, were to compare, for example, (1) authorized return allowances, (2) realized returns and (3) market derived costs of capital, it would show that utilities have not collected excessive revenues from their customers under the existing forms of state and federal regulation. Without empirical support for the assertion that the alleged imbalance between Sections 205 and 206 has caused electric companies to earn more than their true costs of capital, the proponents of this legislation, in my opinion, have not made their case.

4. Please provide more justification for the distinction you make between application of the proposed legislation to power pooling and similar agreements on one hand and "traditional" wholesale transaction on the other.

A. Take the situation as it now exists on the Middle South System. As I previously testified, we have two major agreements subject to the FERC's jurisdiction - the System Agreement and the Grand Gulf Agreement. Together, the two agreements provide for an allocation of the System's production costs among the System Operating

Companies - Louisiana Power & Light Company (LP&L), New Orleans Public Service Company Inc. (NOPSI), Arkansas Power & Light Company (AP&L), and Mississippi Power & Light Company (MP&L). After extensive hearings and briefs, the FERC has established a production cost allocation plan for the System which it found to be just and reasonable. It should also be noted that the FERC approved allocation plan is different from the plan originally proposed by the Middle South System. If the proposed legislation were to become law without an exemption for such agreements, the Middle South System could be subjected to considerable financial uncertainty and instability if complaints were filed under the new law. For example, if we were to assume the following: 1) the states of Arkansas and Mississippi file complaints against those agreements demanding that the plan be changed to shift far more production costs to the state of Louisiana, and the state of Louisiana and the City of New Orleans retaliate with complaints demanding the opposite; 2) there are new Commissioners at the FERC who, despite the final determination of the present Commission, believe that the allocation issue should be reconsidered in a new hearing, and they set a refund effective date; and 3) due to the number of parties involved, the complexity of the issues and FERC's extremely large regulatory responsibilities (gas pipelines, hydroelectric relicensing, electric rates and dispute resolution), it takes two years to decide the issue. During that period of time, the Middle South System would have been exposed to a great deal of uncertainty and risk that it was undercollecting for production costs in some states and overcollecting in other states. Unlike the more typical, and limited refund exposure for any "traditional" wholesale transaction between, for example, AP&L and North Little Rock's municipal electric system, the potential refund exposure during this period of uncertainty with respect to the overall allocation of production costs throughout the System could become enormous. A reallocation of production costs which required, for example, LP&L to refund large sums of money to AP&L and MP&L would not only be extremely divisive, it could possibly cause the financial ruin of LP&L if it were unable to recover its increased cost responsibility at the retail level because of limitations against retroactive rate increases at the retail level. Furthermore, whatever the ultimate result of the complaint cases, this uncertainty would add to the financial risk of investment in our stocks and bonds during the period the litigation continues. This would be true even if the Commission ultimately reaffirmed the current allocation plan and ordered no refunds. And, as I indicated, if a reallocation was implemented retroactive to the refund effective date, and the company or companies with increased cost responsibility could not recover those costs in retail rate surcharges, the System as a whole would have been unfairly penalized by the inability to recover all its production costs. This would be a particularly unreasonable result since the production costs were being collected under a FERC mandated allocation plan which is different from the allocation plan originally proposed by the Middle South System.

I should point out that express statutory relief from such a situation is much preferable to relying on a provision such as contained in H.R. 2858 that the Commission may decide not to require refunds where refunds were not in the public interest. Obviously, the successful complainants could be counted on to argue strenuously that refunds were in the public interest. The question of refunds or no refunds should not be left uncertain no matter how strong the equitable argument against refunds seems under the circumstances I have posited.

Questions of Senator Bumpers for Mr. Jackson

1. What other risks do the companies you represent currently face? What is the nature of those risks, and the impact of those risks on the financial condition of the company?

A. A number of uncertainties are currently confronting the Middle South System. The most significant of these uncertainties relate to (1) the potential effect of the final resolution of certain Grand Gulf 1 rate orders obtained by the System Operating Companies which have either been challenged, reversed by judicial decisions, or are subject to prudence investigations (in particular, the outcome of MP&L's pending appeal to the United States Supreme Court from the Mississippi Supreme Court's February 25, 1987 decision reversing and remanding a retail rate order of the Mississippi Public Service Commission), (2) the ultimate outcome of the FERC's allocation of Grand Gulf 1 capacity and energy, and (3) the continuing suspension of Grand Gulf 2. Adverse regulatory or judicial decisions involving the System Operating Companies' retail rate structures relating to their recovery of Grand Gulf 1 costs could produce varying consequences that could jeopardize the Middle South

System. Without adequate rates to recover Grand Gulf 1 charges, various of the Middle South Companies could suffer such liquidity constraints that they would, in a short period of time, be unable to meet their contractual obligations in respect of the Grand Gulf Station and could be rendered insolvent. The overall financial condition of the Middle South System is very uncertain as a result of these risks.

2. Do the companies you represent ever find it necessary to file notes to their financial statements that have potential financial impact? If so, how often and what is the stated extent of the potential impact? How often do these notes result in qualified financial statements?

A. Yes, it is a requirement of the Securities and Exchange Commission (SEC) to disclose those commitments and contingencies which could materially impact the financial condition of a company. The notes to financial statements of our System companies disclose those items, such as pending court decisions, pending rate decisions, and new accounting standards which could impact their financial condition.

B. At the very minimum, our System companies file quarterly reports with the SEC which include notes to financial statements. Additionally, the external financing plans of each company may require certain filings to be made with the SEC, as the need dictates. Such filings frequently include notes to financial statements.

The stated extent of the potential impact varies. For some contingencies we are able to disclose an approximate dollar impact while others require more general disclosure where we speak in terms of a company being rendered insolvent or facing bankruptcy should an adverse development occur. In addition, general disclosure is made with respect to the impact on a companies' financial condition, liquidity and earnings.

C. The following companies' financial statements have been qualified:

Year	Company
1980-1984	None
1985	MSU, LP&L, NOPSI and SERI
1986	MSU, LP&L, MP&L, NOPSI and SERI

3. If a company faced a refund liability pursuant to S.1567 or H.R. 2858, could this be similarly noted in its financial statement?

A. Yes, as noted in response to Question #2 (a), it is a requirement of the Securities and Exchange Commission to disclose those commitments and contingencies which could materially impact the financial condition of a company. Further, if a refund with interest is deemed probable based on the facts extant at any time financial statements are released to the public, a company would have to provide a loss contingency charge against earnings to the extent of the probable refund. In any event, a utility's independent accountant's opinion would certainly be qualified to disclose any significant refund obligation.

4. If the utilities earn in excess of the allowed rate of return, do the shareholders or the customers receive the excess dollars earned?

A. Should a utility's actual earnings from operations exceed its allowed rate of return, the excess would not be refunded to customers although rates could be reduced prospectively. Similarly, there is no provision for retroactive recovery from customers of inadequate earnings which are less than the allowed rate of return. Furthermore, it is my opinion that, historically, inflation and increasing financing costs have caused utilities to earn less than the allowed rate of return. As you probably know, utility revenue requirements are typically based on test years (other than utilities with formula rates that adjust for actual costs, which by definition would earn no more and no less than the allowed rate of return). Test years are basically a snapshot in time of actual or expected costs based upon historical experience for a typical year. Rates are then set based on these actual or expected costs plus an allowance for recovery of capital costs, including earnings, i.e. the allowed rate of return on investment. These rates are then fixed until changed by the Commission through proceedings initiated under either Section 205 or 206. Obviously, if inflation causes operating expenses to increase above the test year amounts reflected in rates or if a utility's financing costs associated with capital investments increase, and given a fixed rate level, a utility would not earn its allowed rate of return. This scenario, in my opinion, has been the rule historically, rather than the exception. Further, utilities are now and will be increasingly concerned about competitive pricing. I believe this frame of mind significantly influences utilities to refrain from attempting to price their product at non-competitive levels. Rather, I believe utilities in general are seeking more than ever to find ways to reduce costs and, therefore, prices. Also, I believe that the Commission's recent initiatives to examine rates of return earned by jurisdictional utilities is a visible means to insure that just and reasonable earnings levels and no more than those levels are being earned. I really see no likelihood that a systemic overcollection of allowed rates of return is present today or likely in the future.

5. Under Section 205 proceedings in which the company seeks an increase in rates, do investor-owned utilities generally put money into an escrow fund? Provide specific examples.

A. Under Section 205 proceedings, an electric company seeking an increase in rates would probably not put money into an escrow account, but would accumulate cash internally to the extent of a potential refund obligation as a matter of prudent contingency planning. Please note, however, that a rate increase pursuant to Section 205 is significantly different from a decrease pursuant to S.1567 or H.R. 2858. A Section 205 increase is obviously for amounts above current operating revenues, and current operating revenues are the basis for the Company's expenditure planning and financing plans. Under S.1567 or H.R. 2858, a utility's potential refund obligation could be indeterminable and would constitute a decrease from what was previously determined to be a just and reasonable revenue level. To me, it is obvious that a utility could be required to forego expenditures and reevaluate financing plans in order to effectively accumulate cash to prepare for whatever refund potential existed. Although I cannot provide specific examples of electric companies that have escrowed potential Section 205 refund obligations, I do know that we at Middle South accumulate cash by limiting cash expenditures as necessary to prepare for potential rate refunds.

6. Mr. Jackson, on page 7 of your statement you state that there would be no balancing of the interests of consumers and utilities in the imposition of a refund requirement under Section 206. Do you not agree that the

setting of the just and reasonable rate by the FERC, which necessitates that balancing of these very interests, provides sufficient protection for both parties? Does not the "public interest" language in the House-passed bill provide FERC further authority to balance these interests?

A. I do agree that in setting just and reasonable rates, the FERC must balance the particular interests of consumers and the utility and its investors, and that all parties are afforded protection by this balancing. In fact, it is the importance of this protection that leads to my criticism of the proposed legislation.

The protection afforded to the utility and potential investors by the balancing of interests under the just and reasonable standard is seriously eroded if as a result of a complaint proceeding, the FERC can determine that revenues already collected under rates previously found just and reasonable are no longer considered just and reasonable. As discussed in John W. Barr's statement on behalf of Morgan Stanley & Co. Incorporated, investors can currently rely on the security of revenue booked pursuant to FERC regulated rates to support needed equity and debt financings. However, as Mr. Barr points out, if passed as proposed, S.1567 . . . creates an unlimited liability for refunds which raises a serious question whether continued reliance on booked wholesale revenues is justified. There is no comparable situation under Section 205 as it now stands. Under Section 205, a utility is never permitted to retain more than a just and reasonable level of revenues since it must refund, with interest, the amount above that level when it has been determined by the FERC.

Further, when the FERC determines that a particular rate level is just and reasonable, its determination is normally intended to be forward looking for some reasonable period of time. In other words, the rate which is established is one which is found just and reasonable not just for the day or month of the determination but for some months to come. It is recognized in this process that not all projections and estimates will bear out. In some cases actual results will favor ratepayers and, in other cases, they will favor the utility. But a just and reasonable rate is, based on expert judgment and a prospective consideration of all factors, intended to stand as a reasonable compromise for some reasonable period of time; and traditionally, both ratepayers and the utility are bound by that determination. It is a time honored process and as fair as any realistic method of regulation ever proposed by the most outspoken critics of the "just and reasonable standard." The fairness and balance of this process are undermined if FERC can determine that the just and reasonable level for a prior period of time was lower than the level earlier established and relied on by the utility and the capital markets.

The "public interest" language in the House-passed bill could provide some restoration of the reasonable balance which now exists between Sections 205 and 206 if the public interest language is more broadly defined. Otherwise, it will be argued that the public interest standard only precludes the ordering of a refund where the refund would break the ability of the electric utility to provide service or force it into bankruptcy. There would be little protection in the public interest standard if it is restricted to preventing refunds in only those dire circumstances. The standard would need to be much more flexible than that to be of much help. We earnestly hope that should S.1567 or H.R. 2858 become law, it will have an exclusion for power pooling and similar agreements because of the unique and unusually complicated problems posed by them, as I discuss in my answer to Senator Johnston's Question No. 4. If there is no such exemption, then it should be made clear in the legislative history of the bill that the public interest standard should preclude the ordering of refunds in cases involving the reallocation of production costs in a power pooling system. Further there should be an exclusion of those revenues necessary to enable the public utility to obtain financing or to issue new securities and which must be retained by the public utility in order to meet required coverage ratios applicable to the period between the establishment of the refund effective date and the date of the Commission's final order with respect to any such refund.

7. Mr. Jackson, in your oral testimony you stated that 205 and 206 proceedings are "consistent" in that the rate previously approved by FERC remains unchanged until the Commission makes a subsequent determination that the rate is no longer just and reasonable. (p. 57, Transcript) Is this precisely true? Is it not correct that in 205 proceedings the FERC will allow the higher rate requested by the utility to go into effect subject to a possible refund no later than 5 months after a 60 day suspension period? In contrast, in a 206 proceeding, either under existing law or under the amendments proposed in S.1567, is it not true that a new lower rate cannot go into effect until a final determination by FERC that it is just and reasonable?

A. The point I was making on page 57 of the transcript is an extremely important concept which should be clarified. It is correct as your question suggests that when a proposed increase in rates is tendered for filing with FERC under Section 205, normally the higher rate would go into effect no more than seven months later. (Parenthetically, there are exceptions: the utility's filing could be declared "deficient" by the FERC, thereby delaying effectiveness, or the utility could request, as happens, a delayed effective date.) However, the full amount of the increase over the previously authorized just and reasonable level, would be subject to refund with interest. Further, your question is correct in pointing out that under Section 206, "a new lower rate cannot go into effect until a final determination by FERC that it is just and reasonable." There is nothing inappropriate about that since it means that a utility will not be able to collect what has been determined to be an unjust and unreasonable level of revenues, but it will be permitted to rely on the continued effectiveness of previously approved or effective rates until a determination by the FERC to the contrary. An existing rate, once found just and reasonable, stays just and reasonable by law unless and until FERC finds that it will no longer be a just and reasonable rate from that time forward. Thus, the important point is that under existing Sections 205 and 206, the utility would never be permitted to charge a rate and retain the resulting revenues in excess of a rate level which has been determined to be just and reasonable by the FERC. The Section 205 and 206 proceedings are entirely consistent on that critical point, which I also discussed on page 6 of my prepared statement.

8. a) Please explain further what is meant by "coverage requirements"? b) Under Section 206 in present law can FERC set a "just and reasonable rate" that would deny a utility the revenues needed to meet its "coverage requirements". Under what circumstances could this occur? c) If not, are there circumstances under which simply the addition of a refund liability to a reduction in rates would deny a utility the revenues needed to meet its coverage requirements? Could the refund liability be the only determining factor in this revenue calculation? If so, how does the addition of a potential refund liability affect the coverage requirement test?

Generally, "coverage requirements" are the financial tests imposed on the issuance of securities. Such tests are normally imposed by corporate articles of incorporation, bond indentures or SEC regulations, and are designed to protect the interests of existing security holders from dilution or weakening of the financial condition of the company by the issuance of additional securities. The Securities and Exchange Commission (SEC) has mandated substantive coverage requirements under the Public Utility Holding Company Act of 1935 for the issuance of bonds and preferred stock by jurisdictional companies.

An example of a coverage requirement is that commonly required for the issuance of first mortgage bonds: earnings for 12 out of the preceding 15 months must be two times the amount of the annual interest payment required on bonded debt. There are also coverage requirements for the issuance of preferred stock, typically as follows: gross income for 12 of the preceding 15 months must equal 1-1/2 times annual interest and preferred dividends. A company unable to meet its "coverage requirements" will not be able to engage in senior financing.

In addition, "coverage requirements" can also refer to ongoing financial tests limiting the maintenance of prescribed levels of debt. Thus, for example, a company's indebtedness might be limited to no more than 65% of its overall capitalization at any one time.

I do not believe that the FERC intentionally would lower an existing rate level under Section 206 to the point where the utility would be denied revenues needed to meet its coverage requirements. The U.S. Supreme Court held in the landmark case of FPC v. Hope Natural Gas Co. that a just and reasonable rate was one which not only protected consumers but gave the utility "enough revenue not only for operating expenses but also for the capital costs of the business", which "include service on the debt and dividends on the stock." The Court also said the utility's return "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." (emphasis added) Nevertheless, due to the complexities of ratemaking, the separate jurisdictions of the FERC and state or local regulatory bodies, and other factors, it is possible that the decision of the FERC in a Section 206 case could cause a utility's earnings and revenues to fall below levels prescribed for securities issuance tests. This could prevent the utility from financing, or cause the violation of its debt maintenance covenants, thereby triggering default in and acceleration of its indebtedness.

The determination of whether or not an issuer meets a particular coverage test in light of a refund exposure creates a mixed question of law and accounting. The determination of the earnings and revenues of an issuer is primarily an accounting question. The existence of a potential refund obligation is a "loss contingency" requiring the exercise of an accounting judgment about whether or not to include a given item of revenue in the accounts of an issuer. In some cases the accountants may ask for a legal opinion concerning the probability of the issuer suffering the loss (i.e., the refund).

The accountants' determination does not necessarily end the inquiry: coverage tests are imposed by corporate articles of incorporation or contract and in some cases are subject to regulatory scrutiny as well. Thus, a mortgage trustee may independently question the validity of an issuer's reported earnings in light of a known potential refund liability. For example, in 1974 the New York Public Service Commission removed a refund obligation from Long Island Lighting Company because LILCO's mortgage bond trustee had refused to allow revenues subject to refund to be credited in a coverage calculation, thus rendering LILCO unable to issue more bonds (Case No. 26552, October 4, 1974). In addition, use of revenues subject to refund might expose an issuer to a lawsuit by an existing security holder, such tests having been imposed to protect such holders in the first place. While an issuer may bargain with its security holders for a liberal interpretation of revenues (i.e., so as to include all revenues "whether or not subject to refund"), unfortunately, many of these tests are found in contracts which cannot be readily amended in this fashion. In the mid-1970s the SEC required many utilities to disclose revenues and coverages both inclusive and exclusive of revenues subject to refund, thus creating practical if not legal difficulties for issuers with refund exposure.

Ultimately, there is no single answer to this question. However, it can generally be stated that imposition of a refund liability can potentially make it more difficult, if not render impossible, the issuance of senior securities by utilities.

SWIDLER & BERLIN
CHARTERED
3000 K STREET, N.W.
SUITE 300
WASHINGTON, D.C. 20007-3841
(202) 944-4300

EDWARD BERLIN
ATTORNEY AT LAW

DIRECT DIAL
(202) 944-4304
TELEX 701131
TELECOPIER (202) 944-4296

December 16, 1987

(HAND DELIVERED)

Honorable J. Bennett Johnston
Chairman, Senate Committee on
Energy and Natural Resources
Room 306
Dirksen Senate Office Building
Washington, D.C. 20510-6150

Attention: Bill Conway, Senior Counsel

Re: The Regulatory Fairness Act (S. 1567)

Dear Chairman Johnston:

Enclosed is my response to the questions posed by you and by Senator Bumpers.

I have been asked, by former Federal Energy Regulatory Commission Chairman Raymond J. O'Connor, now Vice-President of Citibank, a significant lender to the electric utility industry, to share with you, and the Committee, his views on S. 1567. Copies of his Statement are enclosed. Mr. O'Connor makes the important point that the enactment of S. 1567 would seriously undermine the integrity of utility earnings that are now relied upon as the basis of investment commitments.

I am also forwarding a letter from one of the leading utility audit firms, Coopers & Lybrand, which focuses on a second consequence of enactment of S. 1567: the likelihood that it will result in qualified financial statements. That eventuality should not be lightly dismissed. It is not common for utility financial statements to be qualified and as Coopers & Lybrand observes, "such a qualification in the auditor's report can have negative implications for a utility, including an effect on the stock price and its costs of borrowing."

I very much appreciate the opportunity to share my views with the Committee on S. 1567 and stand ready to assist in the future.

Sincerely,

Edward Berl

Edward Berlin

Enclosures
cc: Senator Dale Bumpers
Senator Wendell A. Ford
Raymond J. O'Connor
John R. Leidy

RESPONSES OF EDWARD BERLIN TO QUESTIONS OF CHAIRMAN JOHNSTON ON S. 1567

1. In the very recent past we have seen the culmination of an era of base-load generation projects, principally nuclear. The utility industry became committed to these projects beginning in the mid-1970's in response, in large part, to the oil supply and price crisis and the national imperative that we seek to achieve energy independence. Investors stepped forward. They were willing to make the requisite funds available at reasonable costs confident that utilities would be assured the return of the invested capital as well as a fair return on that investment. What followed was truly unanticipated. We experienced a period of unprecedented inflation and high interest costs and large capital intensive construction projects were particularly affected. In the midst of this near financial crisis the accident at Three Mile Island occurred and the nuclear industry was thrown into a state of uncertainty. The immediate consequence was to delay many projects; the ultimate effect was, in many cases, to require expensive, disruptive retrofits. Finally, oil prices declined precipitously and with it the national commitment to self-sufficiency. All of this occurred after billions had been committed to these projects. Utilities and regulatory commissions began to reexamine whether projects should be completed. In some cases it was determined that considerations of least-cost planning dictated abandonment. In other instances, completion was determined to be in the best interest of consumers.

It is the case that in most regulatory jurisdictions a utility is not permitted to earn a return on its invested capital until the project is completed. Prior to that time a utility capitalizes interest in the form of non-cash earnings (Allowance for Funds used During Construction. The FERC permits a current cash return on up to 50 percent of construction expenditures). Because of the extension of the construction period, and the high interests costs experienced during the late 1970's and early 1980's, AFDC levels were unusually high placing further pressure on plant costs.

When units were abandoned, utilities applied for permission to recover their invested capital. In several significant instances, either as a result of recently enacted legislation, or regulatory or judicial construction of the "used and useful" language that appears in most regulatory statutes, utilities -- and their investors -- were told for the first time that recovery will not be permitted for investments in abandoned plants. In other cases, for example in the case of investments subject to the jurisdiction of the FERC, utilities and their investors were told that while prudent investments in abandoned plant will be recovered over a reasonable amortization period, a return would not be permitted on the unamortized balance. The effect of that rule, depending on the length of the amortization period, can be to deny recovery of as much as 50 percent of a utility's prudent investment.

Most units were not cancelled. Instead, considerations of least-cost power supply planning dictated completion. Upon completion, however, two new problems developed. In isolated, but highly visible instances, political opposition was directed at the issue that previously had been considered by the Nuclear Regulatory Commission (actually the Atomic Energy Commission) when it first approved construction of the unit -- the suitability of the site for a nuclear power plant. In other instances, utilities were made to suffer large prudence disallowances.

Because of these new realities we simply cannot be sanguine that investor willingness to provide the capital required by the electric utility industry in the past -- at reasonable cost -- will continue in the future. In answer to your question, it simply is inappropriate to look to the industry's historical performance as a gauge of what is likely in the future.

The critical point is that the industry will need to raise large amounts of capital in the near future. Capacity already is becoming critically tight in many parts of the country and we must not be cavalier about our increasing dependency on oil. The experiences recounted above already throw a significant cloud over the industry's ability to raise capital because investors no longer can be confident that regulators will allow a return on and of that investment. At a minimum, the new risks confronted by utility investors will be translated into higher required returns, and higher returns mean higher costs for consumers over the entire depreciable life of the unit.

As a result, investors already are mindful that they cannot be sanguine that when a unit is abandoned or completed the utility will be provided with sufficient revenues to satisfy its commitments made to investors. The entirely new risk that would follow enactment of S. 1567 is that investors will be told that they cannot even view with confidence revenues previously collected pursuant to "last clean rates," that is, revenues collected pursuant to rates that previously were determined to be "just and reasonable."

2. I cannot predict the level of the risk premium that investors will demand in response to the enactment of S. 1567. In view of the capital intensive nature of the industry it does not, however, require that the premium be large for the result to translate into very significant costs that will be passed on to consumers. Moreover, it must be recognized that the risk will pertain to all FERC jurisdictional revenues, whether or not a

Section 206 proceeding has already been initiated. When committing capital, the investor will have to factor in the possibility that a proceeding may be initiated.

I recognize that the end result of such a Section 206 proceeding will be to fix rates, albeit retrospectively, at the level that the Commission determines to be "just and reasonable" and, at first blush, it is difficult to see why anyone should object to that result. The establishment of "just and reasonable" rates is, after all, what regulation should strive to achieve. But it is important to understand how regulation proceeds. When a utility files for a rate increase, seeking the establishment of rates that would apply during a subsequent period, it bases its request on its best estimate of what expenses and revenues are likely to be during that future period. And it is on the basis of competing estimates that the Commission establishes rates. It is axiomatic that individual cost estimates may prove to be higher or lower than actuals. The Commission has historically adhered to this well established method of ratemaking, however, on the premise that overall differences in estimates generally level out. Occasionally, overall estimates, as compared to actual costs, turn out to be too high or too low. As a result, the utility is provided an opportunity to earn above or below its authorized return. But everyone understands that risk and it has been accepted.

Following the enactment of S. 1567 the balance will change; when experience establishes that rates may have been too high revenues will be subject to recapture. Where, however, the rates were inadequate, the utility cannot be made whole. That is not a level playing field and investors cannot be expected to accept the change as one which is costless to them.

It is also important to recognize that the current practice provides a powerful efficiency incentive. If a utility is able to achieve a higher level of productivity than had been assumed in the estimate, it will enjoy an opportunity to realize a higher return. While this will benefit shareholders in the short-run, the long-run beneficiaries will be ratepayers as achieved efficiencies are factored into rates. If efficiency gains are subject to recapture, as would be the case under S. 1567, this important incentive will be eroded.

It is also critical that attention be focused on the "leveraging" effect. Utilities characteristically collect large revenues of which net income is but a small percentage. As a consequence, placing a cloud over even a modest portion of revenues can impose a significant risk to earnings. This point is addressed specifically in the letter from Coopers & Lybrand.

Finally, the Commission has already demonstrated, in the Yankee cases,[1] that it can move Section 206 applications to an expedited resolution. In those cases the Commission issued its decision within seven months. Contrast that with the situation that confronts a utility that is experiencing costs that are not reflected in rates. It typically takes 4 to 6 months to prepare a rate application that is in compliance with the Commission's detailed filing requirements and then, again typically, the filing is subject to a 2-month notice and a 5-month suspension period before the requested increase is put into effect subject to a refund obligation with interest compounded at the prime rate.

Thus, I do not agree that in the final analysis consumers will realize "counterbalancing benefits." The investment community is unlikely to accept a radical departure from current practice without demanding adequate compensation; it seems far preferable for the Commission to continue its efforts to expedite all rate proceedings, be they pursuant to Section 205 or 206.

3. The legislation is not addressed to filing requirements and presumably the Commission would be free to establish minimum filing requirements. The point is that it has done so, in great detail, with respect to Section 205 rate filings but has not imposed comparable requirements on Section 206 applicants. Since S. 1567 would impose a refund potential, it should be incumbent upon the applicant, or upon the Commission where it is the initiating party, to specify the contentions, and the anticipated dollar impact, both so that the utility is given a fair opportunity to meet the challenge and to afford the utility a reasonable opportunity to estimate its potential exposure -- something which may be critically important from both an accounting and financial standpoint.

4. A test period is appropriate to establish what is at issue and avoid a "moving target." Those are the rules by which utilities are governed; they should apply no less to Section 206 applicants.

5. Under Section 206 as it has stood since enacted in 1935, there is no issue as to the dollars that are in "jeopardy." A Section 206 order reducing rates can only be placed in effect prospectively -- a considered judgment by the 1935 Congress and one that has worked well and helped to assure that capital would be available, as needed, at reasonable rates. It simply has never been the case that dollars collected pursuant to rates previously accepted as "just and reasonable" will be subject to recapture. S. 1567 would present a situation that has not, and cannot occur under Section 206 as now written.

---

[1] Opinion No. 285 (September 30, 1987), involving Yankee Atomic Electric Company, Vermont Yankee Nuclear Power Corporation and Connecticut Yankee Atomic Power Company.

RESPONSES OF EDWARD BERLIN TO QUESTIONS OF SENATOR BUMPERS ON S. 1567

1. I respectfully urge that you consider my response to the first question addressed by Chairman Johnston. It does not, I hasten to add, catalogue all of the significant risks that are now being imposed on utilities. For example, in recent years, with the precipitous decline in fuel prices, regulatory commissions are questioning the reasonableness of long-term contractual and captive fuel supply arrangements that were negotiated under far different circumstances. As a consequence, the utility may be unable to recover all of its fuel expenditures. The result is to impose a significant new risk on utility investors, a risk which is exacerbated by exogenous events in the world fuel markets which no one had the foresight to anticipate.

Utility investors will not be unmindful of those events as they are called upon to supply additional capital. That, of course, is a problem that exists independent of S. 1567. But before any incremental risk is imposed, we should be confident that the benefits are likely to exceed the associated costs.

2. It was suggested at the Hearing, by a public power representative, that it is rather commonplace for utility financial statements to be qualified and, presumably, we therefore can be indifferent if that is the effect of enactment of S. 1567. I do not agree.

Utility financial statements are not typically qualified; indeed, the overwhelming majority are not. Qualification should not, moreover, be taken lightly. It is intended to be a signal to the financial community and it is so understood. Plainly, it is signaling a risk to be considered.

I suggest that the enactment of S. 1567 is likely to expand, significantly, on the number of qualified financial statements. Because of the understandable interest that both you and Senator Ford indicated with respect to this important question, I asked Coopers & Lybrand, one of the leading utility auditors, to consider whether the enactment of S. 1567 would likely lead to qualified financial statements. Coopers & Lybrand responded in the affirmative (a copy of its letter is attached) making the important point that, "[n]eedless to say, such a qualification in the auditor's report can have negative implications for a utility, including an effect on its stock price and its cost of borrowing."

3. I believe it likely that in most cases a refund potential pursuant to a S. 1567 proceeding would have to be noted in the utility's financial statement and could well lead to a qualification. Again, I urge consideration of the advice that has been provided by Coopers & Lybrand.

4. The excess would be retained by shareholders until either the completion of a Section 206 proceeding or the filing of a rate reduction by the utility. Utilities do file voluntary rate reductions; indeed, that is precisely what New England Power Company did this year, after first adjusting its rates downward in a filing with the FERC last year to reflect federal income tax changes.

But by way of a more direct answer, I urge that you consider my response to Chairman Johnston's second question where I describe that under the current practice, where rates are based on estimates, it is accepted, and to be expected, that on occasion utilities will earn above their authorized returns, and on occasion below. The difficulty with S. 1567 is that it would remove the symmetry, virtually guaranteeing that on average utilities will always earn less than compensable returns. Further, as I indicate in that response, the legislation would dampen an important efficiency incentive, to the long-term prejudice of consumers.

5. Under Section 205 utilities are able to estimate the maximum level of the refund exposure to which they may be subject -- it is equal to the amount of the proposed increase. But there is no requirement, even in the case of Section 205 applications, that utilities establish an escrow for potential refunds. Nevertheless, it is recognized that the revenues associated with the increase proposed in a Section 205 filing have not yet been adjudicated to be appropriate. The filing, to the extent of the proposed increase, is not "clean." It is therefore understood that the utility's entitlement to those revenues has yet to be determined. Investors can factor that in as they make coverage and other assessments. But once a rate is established, once it is "clean", investors assume that the associated revenues will be available to the utility for the discharge of its obligations. S. 1567 will change that to the detriment, I am convinced, of the very consumers whose interests are sought to be furthered.

APPENDIX II

Additional Material Submitted for the Record

ARKANSAS
PUBLIC SERVICE COMMISSION
1000 Center
P.O. Box C-400
LITTLE ROCK 72203

Jerrell C. Clark
Director
371-1794

Robert E. Johnston
Chairman
371-1453

Patricia S. Qualls
Commissioner
371-1451

Julius D. Kearney
Commissioner
371-1451

August 12, 1987

The Honorable Beryl Anthony
United States Representative
1117 Longworth Building
Washington, D.C. 20515

Dear Representative Anthony:

On July 1, H. R. 2858, a bill proposing the Regulatory Fairness Act of 1987, was introduced and referred to the Committee on Energy and Commerce. This bill, if passed, would amend the Federal Power Act to place the process for reducing wholesale rates on a par with the rate increase process.

Under the current structure, when a utility requests a wholesale rate increase at FERC, a 60-day waiver period becomes effective. The requested increase may be placed into effect from one day to five months after the waiver period. If, after subsequent hearings and appeals, any part of the increase is deemed to be excessive, the overcollection is refunded with interest.

On the other hand, if costs go down and the utility's consumers request a rate reduction or the Commission initiates its own investigation into the rates charged by a utility, any decrease in rates ultimately ordered is not retroactive. Because there is a large case load at the FERC, it could take as much as two years for the FERC to completely process a rate decrease case and issue a final order. Therefore, the ratepayers would have been paying excessive rates for at least two years but there is no recourse available to them.

H. R. 2858 would institute a 60-day waiver period and empower the Commission to establish a date on which the refunds become efffective. That refund effective date would be no earlier than 60 days after the initiation of the action nor later than 5 months after the expiration of the 60-day waiver period.

The Honorable Beryl Anthony
Page 2
August 12, 1987

The Arkansas Public Service Commission supports H. R. 2858 as a means of making the regulatory process more equitable. Making rate reductions effective with the above process would give ratepayers equal treatment in both rate increase and rate decrease situations. We believe that this is a much needed change in the Federal Power Act. We urge that you support H. R. 2858. If you would like to discuss this with us, feel free to call.

Sincerely,

Robert E. Johnston, Chairman

Pat Qualls

Patricia S. Qualls, Commissioner

Julius D. Kearney, Commissioner

cc: Paul Rodgers

STATE OF CONNECTICUT
DEPARTMENT OF PUBLIC UTILITY CONTROL

COPY

RECEIVED
JUL 02 1987
CMEEC

June 29, 1987

Senator Christopher J. Dodd
324 Senate Hart Office Building
2nd Street & Constitution Avenue, N.E.
Washington, D.C. 20510

Dear Senator Dodd:

I am writing to ask you to support legislation, being introduced in the Congress by Rep. Sam Gejdenson (D-Conn.) and Rep. Terry Bruce (D-Ill.), to amend Section 206 of the Federal Power Act.

The proposed amendment, copy attached, is designed to protect electric consumers from having to pay higher-than-necessary rates as a result of inequities in wholesale power rate adjustment procedures.

Under current law, when an investor-owned utility files for a wholesale rate increase under Section 205, the increase goes into effect after a suspension period of from one day to five months. If the Federal Energy Regulatory Commission (FERC) later finds that the increase was not warranted, the overcharges are refunded to customers.

However, if a wholesale customer believes it is being overcharged by its supplier and files for a decrease under Section 206, the case must be fully adjudicated or settled before rates are lowered. Moreover, the new lower rates are put into effect on a "prospective" basis only--there are no refunds of overcharges that the customer paid to the supplier for the duration of the case, which can take as long as two or three years to resolve.

I believe a more balanced approach is needed to ensure that wholesale power suppliers and their customers are dealt with on an equal footing in rate cases, and I believe the proposed amendment to Section 206 provides that balanced approach. I urge you to support it.

If you have any questions on this bill, please do not hesitate to contact me. Thank you for your consideration.

Sincerely,

John T. Downey
Chairperson, Department of Public Utility Control

cc: Members of the Connecticut Congressional delegation
Dan Adamson, Cong. Gejdenson's Office
Robert Naylor, CMEEC
Governor William O'Neill's Office

Encl: Copy of proposed bill
JTD/tb

One Central Park Plaza • New Britain, Connecticut 06051

STATE OF ILLINOIS
Illinois Commerce Commission

MARY B. BUSHNELL
Chairman

STATE OF ILLINOIS CENTER
100 West Randolph Street
Suite 9 – 100
Chicago, Illinois 60601

October 19, 1987

The Honorable Terry Bruce, M.C.
United States House of Representatives
Washington, D.C. 20515

Dear Representative Bruce:

The Illinois Commerce Commission supports passage of H.R. 2858, a bill proposing the Regulatory Fairness Act of 1987, introduced by Representative Terry Bruce and sponsored by the American Public Power Association. The bill was recently passed by the House Committee on Energy and Commerce.

The Regulatory Fairness Act will correct a serious inequity under the Federal Power Act. At present, rate increases for wholesale suppliers of electricity may go into effect following a short suspension period before the Federal Energy Regulatory Commission (FERC). Rate decreases do not receive the same expedited treatment and no retroactive refunds are granted.

H.R. 2858 requires the FERC to provide for refunds effective as early as 60 days from the filing of complaints once they are successful. Accordingly, wholesale electric customers will receive proper relief both prospectively and retroactively. The remedy provided by the bill is critical given expanding wholesale power markets and increasing participation in FERC proceedings by state regulatory agencies, consumer advocates, and other parties.

The Illinois Commerce Commission greatly appreciates your support of H.R. 2858.

Very truly yours,

Mary B. Bushnell

Mary B. Bushnell
Chairman

MBB/jb

The Commonwealth of Massachusetts
HOUSE OF REPRESENTATIVES
STATE HOUSE, BOSTON 02133

JOHN F. MACGOVERN
2ND MIDDLESEX DISTRICT
ROOM 473F
617/722-2210

NOEL DANFORTH
ADMINISTRATIVE ASSISTANT

Committees on
Housing & Urban Development
Transportation

Chairman
John F. Kennedy
Memorial Commission

November 13, 1987

SENATE COMMITTEE ON
AND NATURAL RESOU
RECEIVED
NOV 25 1987
WASHINGTON, D.C. 20510

Senator J. Bennett Johnston
Committee on Energy and
Natural Resources
136 SHOB
Washington, DC 20515

Dear Senator Johnston,

I am writing to urge your support of the Regulatory Fairness Act of 1987. I understand a companion bill has passed the House and it is my hope that the Senate will act on their version favorably before the year's end. Thank you.

Sincerely,

John F. MacGovern
JOHN F. MACGOVERN
State Representative

JFM:slc

STATE OF MINNESOTA
DEPARTMENT OF PUBLIC SERV
7TH FLOOR AMERICAN CENTER BLD
KELLOGG & ROBERT STS
SAINT PAUL 55101

August 14, 1987

Representative
Washington, DC 20515

Re: Regulatory Fairness Act (H.F. 2858)

Dear Representative:

I am writing in regard to recently introduced legislation which will protect consumers from unfairly high electric rates by enabling timely and full relief from proposed rate decreases. The Minnesota Energy Issues Intervention Office (EIIO) asks for your support of H.F. 2858.

The Regulatory Fairness Act (H.F. 2858) seeks to change prior procedural inequities in the Federal Power Act. Under current law if an electric utility files for a rate increase, the utility implements the rate request as soon as one day to five months later. However, when the Commission or a wholesale customer seeks a rate decrease the new rate can only go into effect *prospectively* after final FERC determination. The EIIO believes that whether the utility company or the FERC initiates rate changes, the same rate procedure should be followed.

The Regulatory Fairness Act amends / 206 of the Federal Power Act to require utilities to refund amounts in excess of the FERC determined fair rate with interest. The bill has strong bipartisan sponsorship and support in the Congress, and there is currently no opposition to the bill.

The Regulatory Fairness Act takes on added importance because the profitability of electric utilities is increasing, and the Commission is beginning to institute / 206 investigations into the return on equity of certain utilities. According to the National Association of Regulatory Commissioners, the profitability of electric utilities is higher than the average return on investment of industrial corporations. For example, Northern States Power's return on investment was 11.60 percent, whereas the industrial average was 9.4 percent.

AN EQUAL OPPORTUNITY EMPLOYER

Under the current procedures there is less incentive to file for a rate decrease. For instance, during the two years it takes to conduct a rate proceeding, economic conditions may change, and induce the utility to file the next day for a change in rates. There may be no refund because rates are prospective. Furthermore, because a rate examination can take up to two years, there is little incentive for utilities to settle because rates can be collected over the length of the rate proceeding.

The EIIO urges you to support the Regulatory Fairness Act (H.F. 2858) without amendments. Thank you for your attention in this matter. If you have any questions please do not hesitate to call me at 296-7128.

Sincerely,

Marice Rosenberg
Director, EIIO

MISSISSIPPI PUBLIC SERVICE COMMISSION

NIELSEN COCHRAN, CHAIRMAN
JACKSON-FIRST DISTRICT
LYNN HAVENS, VICE CHAIRMAN
GULFPORT-SECOND DISTRICT
D. W. SNYDER, COMMISSIONER
EUPORA-THIRD DISTRICT

BRIAN U. RAY
EXECUTIVE SECRETARY
WALTER SILLERS STATE OFFICE BLDG.
P.O. BOX 1174
JACKSON, MISSISSIPPI 39215-1174

DENNIS W. MILLER, ATTORNEY
COMMISSION STAFF
BILL SUMMERS, DIRECTOR
PUBLIC UTILITY STAFF
RICHARD WISE, ATTORNEY
PUBLIC UTILITY STAFF

August 28, 1987

Same letter sent to:
Senator Stennis
Senator Cochran
Representative Trent Lott
Representative Mike Espy
Representative Wayne Dowdy
Representative Sonny Montgomery
Representative Jamie L. Whitten

Senator Thad Cochran
United States Senate
[illegible] Russell Senate Office Building
Washington, D.C. 20510

RE: The Regulatory Fairness Act of 1987
H.R.2858

Dear Senator Cochran:

Representatives Terry Bruce (D-Ill.) and Sam Gejdenson (D-Conn.) are co-sponsoring H.R.2858 entitled the "Regulatory Fairness Act of 1987". The Mississippi Public Service Commission would solicit your support of this act on behalf of Mississippi electric consumers.

Basically, the act puts consumers on equal procedural footing with electric utilities in rate matters decided by the Federal Energy Regulatory Commission (FERC). Presently, the Federal Power Act allows an electric utility to institute a rate increase prior to final regulatory approval by placing the increased rates in effect under bond. Rate decreases, however, are not presently allowed to become effective until after final regulatory approval. The Regulatory Fairness Act would cure this inequity.

I am enclosing for your convenience a copy of the bill together with a fact sheet and other information prepared by the American Public Power Association. We believe that passage of this bill would be greatly beneficial to the ratepayers of the State of Mississippi and would seek your active support of it.

Senator Thad Cochran
Page 2
August 28, 1987

Should you or your staff have any questions concerning the matter or need any further information please do not hesitate to contact me. We appreciate your consideration in this.

Sincerely yours

Richard W. Wise
General Counsel

RWW:nb

CC: Mr. Bill Summers
Chairman Nielsen Cochran
Commissioner Lynn Havens
Commissioner D. W. Snyder

COMMONWEALTH OF VIRGINIA

ELIZABETH B. LACY
CHAIRMAN
PRESTON C. SHANNON
COMMISSIONER
THOMAS P. HARWOOD, JR.
COMMISSIONER

GEORGE W. BRYANT, JR.
CLERK OF THE COMMISSION
BOX 1197
RICHMOND, VIRGINIA 23209

STATE CORPORATION COMMISSION

August 13, 1987

The Honorable Frederick C. Boucher
Member, House of Representatives
428 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Boucher:

The Virginia State Corporation Commission respectfully directs your attention to H.B. 2858, "The Regulatory Fairness Act." This bill essentially proposes that the current law be changed such that the effective date of decreases in electric wholesale power rates mandated by the FERC be handled in the same fashion as rate increases.

Currently, filings for these rate increases are waived for a period of 60 days. Interim rates may be placed in effect between one day and five months from the end of the waiver period. These rates are interim and subject to refund pending a final Commission decision.

Rate decreases, on the other hand, are granted only after the FERC reaches a final decision; there is no provision for an interim decrease. The difference between the handling of rate decreases versus rate increases is clearly skewed to the detriment of the ratepayer.

We believe that it is equitable to handle the timing of all electric wholesale power rate changes in the same fashion. Your support of this bill would inure to the benefit of customers of Virginia's twelve electric cooperatives, and municipally owned electric power systems.

Should you have questions or comments, we would be happy to address them.

Sincerely,

Elizabeth B. Lacy
Chairman

Preston C. Shannon
Commissioner

Thomas P. Harwood Jr.
Thomas P. Harwood, Jr.
Commissioner

State of Wisconsin \ PUBLIC SERVICE COMMISSION

CHARLES H THOMPSON CHAIRMAN
MARY LOU MUNTS COMMISSIONER
GEORGE R EDGAR COMMISSIONER

4802 Sheboygan Avenue
P O Box 7854
Madison Wisconsin 53707

July 31, 1987

Honorable Les Aspin
United States House of Representatives
Washington, DC 20515

Re: Amendment of the Federal Power Act, H.R. 2858

Dear Representative Aspin:

I am writing to you in support of H.R. 2858, a bill proposing the Regulatory Fairness Act of 1987. The bill, as introduced by Representative Bruce (D.-Ill.) and Representative Gejdenson (D.-Conn.), would provide a more equitable procedure for securing wholesale utility rate decreases from the Federal Energy Regulatory Commission (FERC).

The Public Service Commission of Wisconsin (PSCW) regulates 82 municipal electric utilities and several investor owned utilities which purchase most or all of their wholesale power requirements under rates established by the FERC. The cost of wholesale power amounts to about 85-90% of the total cost of those utilities of providing service. Therefore, wholesale power is the most important cost to the ultimate retail customers of Wisconsin's municipal and small private utilities.

Under the Federal Power Act, wholesale rate increase requests filed with the FERC are generally permitted to take effect subject to refund after 60 days notice. This procedure protects utilities against regulatory lag because FERC's processing of rate cases may take from several months to a year or more.

Rate decreases are a different story. To obtain a rate decrease, a customer must file a complaint with the FERC. The FERC will review the complaint and may institute a proceeding, but there are no time limits established on either how long the initial review period will be, or how long, once established, the formal proceedings may extend. No rate decrease can take effect until the final FERC order is issued, and the relief is prospective only. This means that even if the FERC determines that a utility's wholesale rate has been excessive for over a year, a customer has no remedy for those past overpayments.

H.R. 2858 proposes that a refund effective date be established for rate decrease complaints. Under the proposal, if the FERC's investigation concludes that rates are excessive, utilities would be required to return overpayments to customers that occurred from the refund effective date to the date the FERC lowers rates to the appropriate level. The proposed change simply insures that decreased rates and increased rates are handled in the same manner and afforded the same considerations.

My fellow commissioners and I urge your support of H.R. 2858 to facilitate reasonable costs for Wisconsin's utility ratepayers. If you have any questions about this issue, please contact me. Thank you.

Sincerely,

Charles H. Thompson
Chairman

CHT:GM:reb07298707

AMERICAN PUBLIC POWER ASSOCIATION

2301 M STREET NW WASHINGTON DC 20037 · 202/775-8300

'88 FEB 23 11 8 36

OFFICERS
President JOE H. EXUM
President-elect WALTER A. CANNEY
Vice President WILLIAM C. MESCHER
Treasurer C. M. PERKINS
Executive Director LARRY HOBART

DIRECTORS
JAMES A. BAUER
Piedmont Municipal Power Agency
Greer, South Carolina
JOSEPH BLAIN
Taunton, Massachusetts
RONALD W. BOLES
Huntsville, Alabama
WALTER A. CANNEY
Lincoln, Nebraska
BILL D. CARNAHAN
Riverside, California
DON COLLETTE
McMinnville, Tennessee
GERALD L. COPP
Wenatchee, Washington
E. LEON DAGGETT
Hamilton, Ohio
MOLLY DARWIN
Morganton, North Carolina
R. HARRY DAWSON
Oklahoma Municipal Power Authority
Edmond, Oklahoma
DWIGHT F. DAY
Utah Associated Municipal Power Systems
Salt Lake City, Utah
JOE H. EXUM
Jackson, Tennessee
ERNEST GEDDES
Turlock, California
GILBERT E. HANSON, JR.
Kansas Municipal Energy Agency
Mission, Kansas
RANDALL W. HARDY
Seattle, Washington
RICHARD HORKINS
Toronto, Ontario, Canada
EDWIN C. HOSKINS
Knoxville, Tennessee
EARL LAMAACK
Missouri Basin Municipal Power Agency
Alexandria, Minnesota
STEVE LOVELAND
Springfield, Oregon
ROYCE LYLES
Jacksonville, Florida
CAROLYN S. MCNEIL
Utah Associated Municipal Power Systems
Sandy, Utah
WILLIAM C. MESCHER
Santee Cooper
Moncks Corner, South Carolina
TIM MORAWSKI
Holland, Michigan
BOB NELSON
Denton, Texas
NORMAN NICHOLS
Los Angeles, California
REECE D. NIELSEN
Intermountain Power Agency
Hyrum, Utah
PAUL W. OSLER
Indiana Municipal Electric Association
Carmel, Indiana
DAVID W. PENN
Wisconsin Public Power Inc. System
Sun Prairie, Wisconsin
C. M. PERKINS
Salt River Project
Phoenix, Arizona
CHARLES F. ROSSOLL
Norwich, Connecticut
ROBERT E. ROUNDTREE
Springfield, Missouri
DON E. SCHAUFELBERGER
Nebraska Public Power District
Columbus, Nebraska
E. C. SHREVE, JR.
Florida Municipal Utilities Association
Tallahassee, Florida
DONALD L. STOKLEY
Municipal Electric Authority of Georgia
Atlanta, Georgia
WILLIAM G. TOBIN
Rock Rapids, Iowa
ROBERT N. VAISEY
Fairport, New York

February 19, 1988

Honorable J. Bennett Johnston
Chairman
Senate Energy and Natural Resources
  Committee
360 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

I am submitting the attached analysis in response to the statements prepared by various financial institutions suggesting that enactment of the Regulatory Fairness Act (S. 1567/H.R. 2858) could create significant new financial risks for investor-owned utilities.

The American Public Power Association believes enactment of this legislation will establish equity in the regulation of wholesale electric rates without imposing undue risk upon the private power companies or their shareholders. To assess the merits of the arguments presented to the Committee by various accounting and investment firms, APPA commissioned Professors Howard E. Thompson and Thomas H. Williams of the University of Wisconsin to analyze these statements and the financial impact of this legislation upon the investor-owned utilities.

According to this analysis, the argument of dramatic financial fallout from enactment of this legislation is unfounded. Contrary to these claims, the analysis determines that:

> "refund procedures under a revised Section 206 will have no incremental impact on the number of companies that are subject to financial distress....If a company is financially weak without a refund procedure it will be weak with one. If it is sound without the provision it will be sound with one."

(over)

Honorable J. Bennett Johnston
February 19, 1988
Page Two

I hope that, having reviewed both sides of this issue, the Committee will move expeditiously to markup this legislation. Please feel free to contact me if you would like to discuss this report of the legislation in further detail.

Sincerely,

Larry Hobart
Executive Director

enclosure

LH/mpm

STATEMENT OF

DR. HOWARD E. THOMPSON AND DR. THOMAS H. WILLIAMS

ON

THE REGULATORY FAIRNESS ACT OF 1987

FEBRUARY 15, 1988

My name is Howard E. Thompson, and I am Kuechenmeister-Bascom Professor of Business at the Graduate School of Business of the University of Wisconsin-Madison. My field of expertise is corporate finance with specialization in utility regulation. My statement was commissioned by the American Public Power Association and its member systems. I was asked to analyze H.R. 2858, as passed by the United States House of Representatives, and the principles as embodied in S. 1567.

The statement that I make is concurred in by Dr. Thomas H. Williams, Robert Beyer Professor of Accounting and Chairman of the Accounting and Information Systems Department at the University of Wisconsin-Madison. Professor Williams and I worked jointly on the development of this statement and are in agreement on all points which follow.

A. Review of Senate Bill 1567 and Claims by Company Representatives

Senate bill 1567 would change Section 206 of the Federal Power Act to provide that rate reductions ordered under Section 206 be prospective from a refund effective date as contrasted to the date of the Commission order for reduction. This would subject the utility to refunds of rates collected in excess of those found to be just and reasonable. The accumulated excess rates paid between the refund effective date and the order date, with interest, would constitute the amount of the refund.

In enacting this change, symmetry and equity which does not now exist would be established between Section 206 and Section 205. An ideal regulatory system would decide the just and reasonable rate instantaneously and that rate would be ordered into effect. But no regulatory system can approach this ideal. The fact that regulatory proceedings are lengthy and protracted should not allow a company to collect and keep rate revenues that are not just and reasonable. Nor should delay deny a utility a fair return.

At the present time, rate increase requests by utilities under section 205 are put into effect following a one day to five month suspension but before determination of whether the increased rates are just and reasonable. If the just and reasonable rate is eventually determined to be less than the requested rate which customers have been paying, refunds are ordered. The logic of this procedure is straightforward. Thus the refund procedures of Section 205, which call for the payment of interest on the excess rates, contribute to an effective system of regulation.

Section 205 has served the companies well in the period of rising rates that we have experienced over the last twenty years. But its counterpart, Section 206, does not and will not work in an effective manner during times of declining rates. With complaints registered under the present Section 206, if the existing rate is determined to exceed that which is just and reasonable, rates are reduced prospectively from the date the Commission accepts the compliance filing putting the new rate in effect. No refunds are required. If there is a protracted period of time from complaint to order, the system works far from the ideal and excess rates are absorbed by the customer. S. 1567 would correct this inequity.

Representatives of the investor owned utilities oppose this change in Section 206 on the grounds that it will be detrimental to the companies and their stockholders and ultimately to the customers. The main thrust of their argument is that rate reductions under Section 206 are unlimited and therefore potential refunds are unlimited. (Testimony of J. D. Jackson, Nov. 18, 1987 p.7. Testimony of R. O. Mundy, Nov. 8, 1987 p.9) They argue that this is in sharp contrast to Section 205 reductions which are limited to the difference between the requested rate and the existing rate (which serves as a no increase decision on the part of the Commission). Thus, according to the companies, refunds under Section 205 have a definite maximum while those under the proposed Section 206 would not.

The potential for unlimited refunds, they argue, could have serious financial consequences for the utilities. They believe that this legislation creates an added source of risk and uncertainty that will increase the cost of capital and may even prevent the companies from raising capital for necessary projects. (R. O. Mundy p.9-10) Their statements suggest that they believe that the uncertainty arising from refunds could be so significant that the financial statements would be "qualified" by their auditors and that these "qualified" statements would cause a significant increase in the cost of capital to the firm. Furthermore they assert that these refunds could cause interest coverage requirements of bond indentures to be violated thus preventing added financing or accelerating the due dates of existing financing. Finally they argue that these effects would not be limited to utilities experiencing refunds but would be contagious, affecting all utilities.

We believe these arguments are overstated and essentially without merit. Enacting the change to 206 will cause the companies to earn just and reasonable rates and should have no negative influences on investors. Failure to enact the legislation changing Section 206 would surely cause utilities to earn more than just and reasonable rates during periods of declining costs and hence cause customers to overpay. This is undesirable.

In the sections which follow we will discuss in detail why we believe that enacting the proposed changes to Section 206 will not cause the dire consequences that company representatives have predicted.

B. The Effect of the Revised Section 206 on Risk and the Cost of Capital.

1. There will be no direct effects of refund procedures on

the cost of capital.

The cost of capital to a company is affected by the risk which investors perceive. And the cost of capital affects the magnitude of the rates charged to customers for utility service. The greater the risk the greater the cost of capital and the greater the rates which customers must pay.

When rates exceed those that are just and reasonable, customers pay more for the service than if rates were not excessive. Without a refund procedure associated with Section 206 proceedings, customers can pay excessive rates for that period of time between the complaint and the Commission finding of just and reasonable rates.

The company representatives argue that there will be substantial increases in risk and the cost of capital. The main support for this claim stems from their assertion that the increased uncertainty is caused by the ability of regulators to take away revenues previously found lawful. (Response of J.D. Jackson to question 1 of Sen. Johnston, Jan. 4, 1987; Response of E. Berlin to question 1 of Sen. Johnston, Dec. 15, 1987) But taking away lawful revenues is not contemplated in S. 1567. (M. Hesse, FERC response to questions 7 and 8 of Sen. Metzenbaum, Dec. 23, 1987) Revenues collected between the last rate proceeding and the refund effective date are not subject to refund. It is only those revenues collected subsequent to the refund effective date and before the compliance finding that are at issue. The amount of this refund is merely the excess revenues that an ideal regulatory system would have prevented from being collected.

Looked at from the point of view of these customers one has to ask whether the fact of avoiding excessive rates through a revised section 206 can cause increased risks which will negate the rate reductions that the refund procedure would produce? We believe this is highly unlikely.

Potential reductions in rates can arise from two types of situations: either the cost of capital falls (possibly due to reductions in interest rates or costs of money) or other cost of service elements fall (e.g. fuel costs, wage decreases, productivity increases). If either of these two causal factors occurs without a rate reduction, the value of the utility's securities will rise and it will earn more than the new cost of capital. That is, it will earn excess returns. If rates are adjusted to what is just and reasonable the value of the securities will return to the "pre-factor-change" levels and security holders will have no unmerited gains or losses.

If regulation works effectively investors will expect that when the rates depart from just and reasonable, regulation will tend to drive them back to what is just and reasonable. With the present Section 206 there is a stickiness with respect to rate reductions. FERC rates are quick to move up to what is just and reasonable but are slow to move down when such a change is warranted.

There is little uncertainty in the minds of investors as to the ultimate objective of regulation -- to produce just and reasonable rates. But some uncertainty exists as to the precise rates that the Commission will establish in a rate proceeding. In recent years, however, this regulatory uncertainty at the wholesale level has been minimized by the existence of published benchmark rates of return on equity, which are now applied as an advisory guide in Section 206 complaints (FERC Order No. 489, Feb. 1, 1988), and by companies having access to data and FERC "tools" that enable them to predict what the Commission may decide as just and reasonable. (M. Hesse, FERC response to question 9 by Sen. Metzenbaum, Dec. 23, 1987) The extent of this limited uncertainty would be no different if there were refunds associated with Section 206 proceedings.

The extent of potential refunds can surely be estimated as well as we can estimate just and reasonable rates. The same tools apply. The statement by company representatives that refunds are unlimited and the implication that the investor must be completely "in the dark" concerning the magnitude of the potential liability is not credible. (Statement of Edward Berlin before the Senate Committee on Energy and Natural Resources, not dated, p.8)

Investors would like to keep excess returns. It increases their wealth. But providing them with excess returns is not the purpose of regulation. The purpose is to provide them with a rate of return on their securities which is commensurable with other securities of corresponding risk. We do not envision that this risk will change when refund procedures are a part of Section 206.

2. There will be no impact of refunds on risk regardless of the resale arrangements.

The company representatives would like to have power pooling arrangements between affiliated and non-affiliated companies exempted from refunds. They argue that these arrangements are sufficiently complex that risks would be magnified above those risks which would be present in normal wholesale transactions to cities and rural electric systems. (J. D. Jackson, pp.9-11)

There are a variety of resale situations that are governed by the Federal Power Act. They range from companies that sell to wholesale customers such as cities and towns (which have their own distribution system) as well as to their own retail customers; companies that sell to other investor owned but unaffiliated companies as well as to their own retail customers; companies that are jointly owned by affiliated or non-affiliated companies that share the output.

Although there are significant differences between the various wholesale supply arrangements described in the previous paragraph, the uncertainty present in the precise determination of just and reasonable rates in future rate cases is the same for all. The existence of a refund procedure will merely prevent excess returns from being earned when rate reductions are in order. There is no added risk to investors that results from these more complicated power-pooling arrangements.

Consider the case where non-affiliated companies own a generating company that sells exclusively to the owners or their assignees. The "Yankee" companies of New England are of this form. For example Vermont

Yankee is owned by Central Vermont Power (35%), New England Power (20%), Green Mountain Power (20%) and others. No stock of Vermont Yankee is held by the public. Therefore any risks that affect Vermont Yankee will be manifested in the market for the stock of the companies which own Vermont Yankee. Any excess returns which Vermont Yankee earns will be the property of the companies which are its owners. If Vermont Yankee is subject to a refund under a rate reduction resulting from a 206 proceeding, that refund will be paid to the companies which own its stock. In one form or another the companies that own Vermont Yankee will capture the excess return between the refund effective date and the order date. Given this corporate arrangement it appears as if the refund-risk argument has even less impact than it has when the normal wholesale to cities and towns is considered. The real question is whether the ultimate customers will be protected from excess rates.

The case where a single holding company owns all the stock of the wholesale purchasing companies and the wholesale selling companies is similar. Middle South Utilities is an example of this arrangement. Any risk or excess returns that arise from the selling companies is manifested in the stock of the holding company. Any excess return collected by the sellers will contribute to the profit of the holding company. Refunds would flow to the purchasing companies and eventually to the holding company. Again one must argue that there is little impact of the refund procedure and it is hard to see why it would contribute to risk.

That refund procedures do not affect risk in the various resale situations does not mean that shareholders or managements working on their behalf would be indifferent to refunds. In the holding company case it may be preferable, to the stockholder, to pass the excess return from the selling companies to the holding company rather than issue refunds to the purchasing companies and have them intercepted by state regulators and passed on to ratepayers of the purchasing companies.

FERC has stated that there is no reason to treat coordination transactions, power pooling arrangements, and voluntary agreements any differently from requirements sales. (Response of M. Hesse to question 3 by Sen. Johnston, Dec. 23, 1987) Past FERC actions are consistent with this point of view. It has used its limited existing authority to provide "fairness" similar to that which would result from Section 206 refunds in exactly these types of coordinated transactions through the equity reopener provision. In addition H.R. 2858 gives FERC the discretion to decide on a case-by-case basis whether ordering a refund for a cost reallocation would meet the public interest test.

We have argued that refunds will have little if any impact on the cost of capital of the refunding company because we see no reason why risk should increase because of the refunds. To be sure, the excess return earned during the rate reduction complaint period will fall to what is just and reasonable. But this is the intent of regulation.

C. Technicalities of Financing and Their Impact on Refunds and Risk

The companies raise some technical issues associated with refunds. In particular they argue that coverage ratios may be violated because of refunds and they argue that the uncertainties of refunds may lead to "qualified" financial statements. Both of these may jeopardize the financial viability of the utility. (E. Berlin p.7) We discuss these issues in this section.

1. Refunds should not affect violation of bond coverage requirements

An argument has been made that refund provisions could cause interest coverage requirements in bond indentures to be violated thus raising the cost of capital and interfering with needed financing. The coverage requirement in bond indentures generally states that no additional bonds may be issued unless net earnings available for interest for any twelve consecutive months of the preceding fifteen months equal at least twice the annual interest on all bonds. From this type of statement a minimum coverage ratio of two would be required. The argument by the company representatives is that when a refund of previously collected revenues is granted, the net earnings available for interest is adjusted downward by the refund. This downward adjustment could cause the coverage ratio to drop below two and thus prevent any bond issues. But this argument is not convincing.

Lurking behind the argument is the assumption that the management of the utility is passive and unthinking. When an impending financial problem appears on the horizon they apparently make no attempts to protect the company against it. And it may be a refund obligation that finally tips the company over the abyss. We think that this assumption is unrealistic. Company managers have a duty to protect the interests of their stockholders and creditors and by and large they attempt to do so. The usual way this is done is by use of conservative and flexible financing arrangements. For instance, financing with equity as opposed to debt will reduce interest on bonds -- the denominator of the coverage ratio -- and keep the coverage ratio in a non-vulnerable range thus avoiding any potential problem with slight changes in net earnings.

The financing plan of any utility should not be vulnerable to changes in just and reasonable rates over time. Competent managers know these rates will change from time to time and so the financing plan must take this into consideration. These normal changes should not tip the utility into financial distress. If the plan is reasonable, a utility should be able to cope with a change in the cost of capital and with a change in just and reasonable rates. When a rate reduction proceeding is initiated a well managed utility can predict the outcome (as we previously argued) and should be able to deal with that outcome. If the company must rely on not refunding excess returns then it can only avoid financial distress temporarily. Earning power subsequent to the rate order when excess returns cannot be relied upon would, in this extreme case, be insufficient to prevent the coverage ratio from falling below the critical value.

Companies which do not have flexible and conservative financial structures and whose management does not anticipate and react to potential problems are vulnerable to financial distress. But they will be vulnerable whether there are refunds or not. Companies that act prudently but are subject to unpredictable natural or economic forces which lead them toward financial distress will also find themselves in this unenviable position whether there are refunds or not. Refund procedures under a revised Section 206 will have no incremental impact on the number of companies that are subject to financial distress.

There is a small risk that, because of poor management, a refund could be enough to cause the utility to abrogate a bond indenture restriction. But even this unlikely situation is anticipated by the proposed Section 206 approved by the House, and allows the FERC to consider the effect of a refund on the continued financial viability of the utility. If, say, the coverage ratio restriction would be violated if refunds were granted the FERC has the option of waiving the refund to preserve the integrity of the company. The condition for exercising this option is that "such a refund would adversely affect the public interest."

The ability of companies to make decisions that mitigate any adverse consequences of refunds and the FERC's obligation to protect the public interest render the refund provisions of a revised Section 206 insignificant to the financial viability of utilities.

2. Even if refund uncertainties on occasion result in qualified financial statements, this fact should have little economic effect.

Another argument put forth by company representatives is that the uncertainty associated with refunds in Section 206 proceedings will cause auditors to "qualify" the financial statements of the utilities involved. This qualification, they assert, will in turn cause the investors to reduce the price they are willing to pay for the securities thus increasing the cost of capital. We find this prognostication to be grossly exaggerated with little empirical credibility.

An auditor's report, or opinion, on the financial statements of a firm may be "qualified" for several reasons. These reasons include failure to follow GAAP in the preparation of the financial statements, departures from consistent application of selected principles, limitations on the scope of the audit, and the existence of uncertainties about matters affecting the financial statements. The latter reason, which if material gives rise to the so-called "subject to" qualification (disclaimers if the uncertainties are pervasive), is the source of possible audit qualifications that could arise from Section 206 refund uncertainties.

There are two variables associated with the potential loss of previously collected revenues that would result from a Section 206 decision to adjust rates downward: the uncertainty of the disposition of the case, and the magnitude of the potential liability. The uncertainty in the case of Section 206 refunds is whether or not a refund will be granted. In order to determine the proper accounting treatment of the potential refund, FASB Statement No. 5 requires that this uncertainty must be classified as "probable" (the future event is likely to occur), "reasonably possible" (the chance of the future event is more than remote but less than likely), or "remote" (the chance of the future event is slight).

The magnitude of the potential liability determines its "materiality," or potential significance to the investment community. The SEC has defined materiality as follows:

> The term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters about which an average prudent investor ought reasonably to be informed. (SEC Regulation S-X, Rule 1-02)

It is the combination of the two -- uncertainty and materiality -- which is significant to possible qualification of an auditor's opinion. If the rate refund contingency is determined to be "remote," no financial statement disclosure nor audit qualification is required. If a refund is considered "probable" and the amount is material, it is accrued in the financial statements if reasonably estimable or otherwise disclosed in the footnotes to the financial statements. In either case, a qualification of the auditor's opinion is not required if the auditor determines that the provision or disclosure is adequate. Finally, if the refund contingency is considered "reasonably possible" and material, the fact and estimated amount of the contingency must be disclosed in the footnotes to the financial statements. In this case, the auditor frequently includes a "subject to" qualification in the opinion paragraph.

In summary, a qualification of the auditor's report because of a rate refund contingency would normally occur only if the disposition of the refund contingency is classified as "reasonably possible" (one of three categories), and if it occurs, would be considered to have a "material" impact upon the financial statements. This suggests a situation where it is impossible to predict the outcome of the FERC determination of just and reasonable rates. We believe these cases will be the remote exception not the rule.

Qualified financial statements for utilities are not uncommon. A review of 1986 annual reports of electric utilities reveals more than thirty qualifications. Most are due to uncertainties. These "subject to" qualifications arise mainly from disputes over disallowances of construction costs or abandonment of projects, many of which are nuclear. For example Long Island Lighting received a qualified statement stemming from construction of the Shoreham Nuclear Power Station and Nine Mile Point 2 nuclear power plant. The company cannot determine when, if ever, Shoreham will operate and cannot determine the total cost of its share of Nine Mile Point 2. Niagara Mohawk Power also has a qualified financial statement associated with Nine Mile Point 2. Commonwealth Energy System received a qualified statement due to its ownership interest in the Seabrook Project and its abandonment of Units 1 and 2. The recovery of its investment in these units is subject to regulatory approval. Central Vermont Public Service was also qualified because of Seabrook. There are also three separate companies that received qualifications resulting from the uncertainties surrounding the Three Mile Island accident. All of these qualifications arise from situations that are quite different from cases that would arise from rate refunds in routine rate proceedings. It is much more difficult to forecast outcomes in these cases than in rate proceedings. They may also be more significant to the financial health of the companies. In Section 206 rate proceedings, as in Section 205 rate proceedings, we would expect little or no qualification of audit opinions.

Coopers & Lybrand state that "materiality is a judgmental determination" but that generally any adjustment greater than 3% to 5% of net income is considered material. (Letter to E. Berlin, Nov. 14, 1987) We agree with this characterization of the materiality determination process. Materiality decisions are ultimately the result of informed judgments by professional auditors. We do not agree that informed judgments will tend to focus on a 3% materiality threshold.

Although the available evidence is somewhat limited, we did identify in our review of annual reports, a case which suggests more flexibility. In 1985 Philadelphia Electric Company was denied recovery of $73 million of energy costs by the PUC. It charged this amount to expense and thereby reduced 1985 earnings by $34.7 million. But it filed a petition for review by the Commonwealth Court appealing the decision. The income effect of the decision in this case was 6.6% of 1985 net income. Since the amount was reflected in the 1985 financial statement there was apparently no further reason for qualification because of this uncertainty. But the petition for review suggests that the Company did not consider the matter closed although recovery was not probable. In addition hearings at the PUC in connection with $47 million of other replacement energy costs were also underway in 1985. This uncertainty amounted to about 4.3% of net income after adjusting for estimated tax effects. The 1985 financial statement of Philadelphia Electric was not qualified for this uncertainty either but included a footnote stating, "The ultimate resolution of this matter will not have a material adverse effect on the results of operations or financial position of the Company." The mere existence of possible refunds, even if large, resulting from Section 206 does not suggest that qualifications are inevitable.

It is further important to disentangle the effect of a rate refund (which, if granted, clearly reduces the firm's return to a "fair and just" level) from the effect of the auditor's qualification (which merely discloses an inability at that time to make a reasonable estimate of the regulatory outcome). As noted above, there will be no financial statement effect nor auditor report qualification if the amount of the potential refund is determined to be "not material." Assuming the amount of the contingency is material, qualification of the auditor's report is not likely if the rate refund contingency is determined to be either "remote" or "probable" (particularly when subject to reasonable estimation). In the former case, no loss is anticipated, and there is no financial statement effect. In the latter case, the projected refund is reflected in the financial statements as if the decision had been rendered.

When a material refund contingency is classified "reasonably possible," it is probable that the auditor's opinion on the fairness of the financial statements would be qualified "subject to" the resolution of the uncertainty. In this case, economic effects, if any, would be influenced by financial statement users' assessments of the likely results. Whether the effect is more or less than it would have been if known with reasonable certainty has not been established by empirical research in accounting and finance. Several studies have found a slight market effect prior to the release of the financial statements with a qualified auditor opinion, but no further effect is detected after this date. (e.g. Elliott, Journal of Accounting Research (1982), pp.617-637; Dodd, Dopuch, Holthausen, Leftwich, Journal of Accounting and Economics (1984), pp.3-38) This implies that there was no market reaction to the audit qualification. One study of "media disclosures" (primarily newspaper reports as opposed to 10K or annual report disclosures) of subject-to opinions did detect a negative market effect. (Dopuch, Holthausen, Leftwich, Journal of Accounting and Economics (1986), pp.93-117) Because this type of disclosure was rare relative to the number of audit qualifications, the sample size was relatively small. However, the researchers were not able to definitively identify any additional explanations for why their results differ from the other studies of "subject-to" opinions.

In evaluating the implications of this research, it is important to recognize that the "market effects" that the researchers are seeking to isolate include the joint impact of the economic consequences described in the qualification and the auditor qualification itself. Common sense suggests that the dominant source of market effect will be the information about the contingency, not the fact of qualification. Only one study has been able to isolate any market reaction following disclosure of the "subject-to" qualification. While it is possible that some of this effect related to the auditor's opinion, such a conclusion would not be consistent with the results of the other empirical studies.

Thus, we conclude that the existing empirical research provides no support for the conclusion that an audit qualification will increase a company's cost of capital or adversely affect its financial well-being.

D. Conclusions

Section 206 proceedings average nearly two years before disposition. The presence of refund provisions in Section 206 will provide a shift of incentives toward a fair and expeditious settlement. At the present time the incentive to extend the settlement time on the part of the selling companies is strong. The longer the excess return can be earned the better. Wholesale customers such as public power systems and rural cooperatives, on the other hand, have incentives to settle quickly and on disadvantageous terms since the proceedings are relatively more costly to them and their bargaining power is weaker. This is evident in the Commission trial staff's comments in support of the settlement agreement on August 7, 1987 in Wisconsin Public Service Doc. No. EL87-36-000 and Doc. No. EL87-44-001. The staff's analysis concluded that:

> ...the proposed settlement rates indicate that the rates result in excess revenues....Staff, however, believes settlement of the case as proposed is preferable to litigation, because this case was set for hearing under Section 206 of the Federal Power Act, so any relief will be prospective only.

We support the refund provisions which would be inserted into Section 206 of the Federal Power Act as a result of S. 1567. These provisions would provide equitable treatment to ratepayers; would add no risk to the companies; and would provide incentives for expeditious settlement of Section 206 proceedings.

Our analysis of the company representatives' responses suggests a single reason for opposing refunds associated with Section 206 proceedings. A no-refund procedure would allow companies to earn greater returns than are just and reasonable during the period between the complaint and the order. Greater returns are more desirable than lesser returns from the security holders' viewpoint. But it is not fair to the ratepayers who must foot the bill.

A refund procedure would make the rate reduction process associated with Section 206 more equitable from the customer's standpoint. We see no evidence that rate refunds would cause an increase in risks and the accompanying increase in the cost of capital and threat to financial viability. If a company is financially weak without a refund procedure it will be weak with one. If it is sound without the provision it will be sound with it.

We see no disease associated with refunds and thus there can be no contagious effect on the utility industry as a whole.

MORGAN STANLEY

MORGAN STANLEY & CO.
INCORPORATED
1251 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10020

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
RECEIVED
DEC 18 1987
WASHINGTON, D.C. 20510

December 15, 1987

The Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
United States Senate
364 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

Enclosed is a copy of a statement by Morgan Stanley regarding proposed legislation, entitled the "Regulatory Fairness Act" (S.1567). We appreciate the opportunity to submit our comments on this issue and request that they be included in the record related to hearings on this proposed legislation.

Sincerely,

John W. Barr

John W. Barr
Managing Director

Enclosure

STATEMENT OF JOHN W. BARR
ON BEHALF OF MORGAN STANLEY & CO. INCORPORATED
TO THE SENATE COMMITTEE ON ENERGY AND ENERGY RESOURCES
CONCERNING S.1567

Morgan Stanley & Co. Incorporated is pleased to comment on the proposed legislation entitled the "Regulatory Fairness Act" which would amend Section 206 of the Federal Power Act. We have reviewed the proposed legislation from the view point of its impact on the financial condition of investor-owned electric utility companies and their ability to attract future investment capital. As the leading investment bank in the underwriting of securities for the utility industry for the last several years, we have direct knowledge of the views of investors and their requirements for providing additional capital to this important sector of the U.S. economy.

H.R. 2858, as passed by the House, and S.1567, as proposed, could create significant new financial risks for many electric utilities which would have a negative effect on their financial condition and ability to attract needed capital on reasonable terms. In the long run, of course, this would be detrimental to consumers and stockholders alike.

Over time, the FERC has established a ratemaking history which the capital markets have generally considered fair and equitable to the concerns of both ratepayers and investors. Reliance on this established regulatory practice has helped to reduce capital costs for the electric utility industry in general, and particularly for the electric companies subject to considerable FERC rate jurisdiction. A number of electric companies have large parts of their overall business regulated by the FERC, and there are some generating companies which are regulated exclusively by the FERC. In these instances, investors have placed heavy reliance on the sanctity of revenues booked pursuant to FERC-regulated rates to support needed equity and debt financings. This reliance has been justified since revenues collected under rates found just and reasonable by the FERC have proven secure although court appeals have sometimes occurred. Even for electric companies with much smaller parts of their businesses subject to FERC regulation, wholesale revenues previously found just and reasonable by the FERC have contributed financial support for financings for these companies.

If passed as proposed, S.1567, however, creates an unlimited liability for refunds which raises a serious question whether continued investor reliance on recorded wholesale revenues is justified. Prospective investors in the equity or debt issues of an electric company will have to be informed that wholesale revenues already booked by the electric company pursuant to a final and lawful order of the FERC are nevertheless legally subject to refunding with interest any time an intervening party files a complaint at the FERC against the company. I note in passing that this holds true for H.R. 2858 as passed by the House, although that bill is somewhat improved by the addition of the provision that a refund will not be ordered if it would adversely affect the public interest, although the application of this provision may be difficult for investors to predict.

We understand that the complaint may prove meritless, or that it may not seek a refund of all wholesale revenues, or that it is improbable that the FERC would under any circumstances reduce a utility's revenues to zero. Nevertheless, investors consider any theoretical risk, more than ever since the uncertainties in our markets following the Stock Market Crash of October 19, 1987. Moreover, as we understand S.1567, there is no limit to the number of complaints that could be filed against a utility during any period of time, and the potential cumulative effect of multiple complaints could be significantly higher than for any one complaint.

Thus, although the concerns of prospective investors may be partially allayed if the utility can assure them that the complaint is frivolous or that it does not realistically threaten the total amount of a utility's booked wholesale revenues, the additional financial risk posed by S.1567 will clearly exact a price which the utility and its customers will have to pay. Even if investors are convinced that a total refund of all wholesale revenues that have been booked is not possible given the nature of the outstanding complaint, under S.1567 it will be difficult, if not impossible, for investors to estimate or appraise the degree of exposure for refunds.

There is one area of the FERC's jurisdiction where the financial risk posed by the threat of a complaint proceeding under S.1567 and H.R. 2858 as passed would be extreme. That area is FERC's jurisdiction over power pooling agreements or other agreements, usually among affiliated companies, which provide for a particular allocation of all generating costs among the companies in the power pooling system regardless of which company owns which generating unit. Under Section 206 of the Federal Power Act as it now stands, any reallocation of generating cost responsibility as a result of an FERC order would be prospective from the date of the order. If Section 206 is modified by the proposed legislation, however, a new allocation of generating costs could be retroactively applied by the ordering of refunds, thereby shifting wholesale cost responsibility for a prior period. If the company or companies which end up with increased wholesale cost responsibility (those which are required to make refunds) for a prior period of time are unable to recover those increased costs at the retail level because of limitations against retroactive rate increases, the system as a whole will not be able to recover all its generating costs. The potential amount of unrecovered or "trapped" costs for a system or affiliated companies as a result of this application of the legislation could be exceptionally large. Large or not, this possible result seems unfair to investors since the prior allocation of generating costs would have been authorized by the FERC or it would not be in place and it would have been relied upon by them in their financial appraisal.

Under other certain circumstances, we can foresee that financial covenants for the issuance of additional securities could be violated because revenues subject to refund may not be included in earnings tests. This would reduce further financial flexibility and increase financial risks even more.

All in all, there is little doubt that the quality of the revenues and earnings of all utilities with FERC-regulated business will be reduced and that investors will require a higher cost of capital to induce them to buy securities of electric companies subject to FERC jurisdiction. Furthermore, should states take a lead from the federal government and adopt legislation paralleling the proposed S.1567 with respect to revenues derived from state-regulated rates, the stability of overall revenue streams for investor-owned utilities could be called into question, affecting their ability to finance.

In summary, to assure that these negative effects discussed above are not forthcoming, Morgan Stanley & Co. Incorporated respectfully recommends that the proposed legislation, S.1567, not be enacted.

REID & PRIEST
1111 19TH STREET, N. W.
WASHINGTON, D. C. 20036
202 828 0100

NEW YORK OFFICE
40 WEST 57TH STREET
NEW YORK, N. Y. 10019
212 603 2000
CABLE ADDRESS: "REIDAPT"
TELEX: 7105816721 RDPT NYK
220534 RDPT UR
FACSIMILE: 212 603 2206

WASHINGTON OFFICE
TELEX: 440630 RP WASH
FACSIMILE: 202 466 2387
202 659 1611
DIRECT DIAL NUMBER

December 15, 1987

William B. Conway
Senior Counsel
Subcommittee on Water and Power
Committee on Energy and Natural
Resources
United States Senate
Room 306
Senate Dirksen Office Building
Washington, D.C. 20510-6150

Re: S. 1567

Dear Mr. Conway:

As you requested through Bruce Foster, I am transmitting herewith my speech on behalf of Arizona Public Service Company and Southern California Edison Company pertaining to Senator Dale L. Bumpers' proposed amendment to Section 206 of the Federal Power Act. As you may recall from previous conversations with Mr. Foster and Robert Aiken, the two utilities have concerns about the impact of the proposed amendment may have on the *Sierra-Mobile* doctrine and the scope of the remedies available to the Commission under an amended Section 206. The enclosed speech addresses those concerns. The companies would appreciate having their comments included in the legislative record being compiled by the subcommittee on S. 1567.

Should you wish to discuss the comments contained in the speech, please contact me at your convenience.

Sincerely,

Brian J. McManus

BJM:pam

Enclosure

TESTIMONY OF BRIAN J. MCMANUS
ON BEHALF OF ARIZONA PUBLIC SERVICE COMPANY
AND SOUTHERN CALIFORNIA EDISON COMPANY
BEFORE THE SENATE COMMITTEE
ON ENERGY AND NATURAL RESOURCES
CONCERNING S. 1567

Mr. Chairman:

My name is Brian J. McManus. I am an attorney with the law firm of Reid & Priest in Washington, D.C. The firm has long served as counsel for electric utilities from all regions of the country on matters pertaining to the Federal Power Act before the Federal Energy Regulatory Commission and its predecessor, the Federal Power Commission. I am appearing today to present the views of two of our clients, Arizona Public Service Company ("APS") and Southern California Edison Company ("Edison"), on the Regulatory Fairness Act.

APS is an investor-owned utility operating in 11 of the 15 counties of Arizona. The company, which is a subsidiary of Pinnacle West Capital Corporation, has its principal place of business in Phoenix, Arizona. The utility serves at retail approximately 544,000 customers comprising residential, commercial, and industrial end-users of electricity. Those retail sales are subject to regulation by the Arizona Corporation Commission. In addition to the retail sales, APS also sells electricity at wholesale and renders transmission services for other utilities which are both privately and publicly owned. These wholesale and transmission transactions are subject to Sections 205 and 206 of the Federal Power Act as administered by the Federal Energy Regulatory Commission.

Edison, headquartered in Rosemead, California, likewise is an investor-owned utility operating in the southern portion of California. The company serves approximately 3.7 million customers at retail. The retail operations, which comprise about 97% of the company's revenues, are regulated by the California Public Utilities Commission. The Federal Energy Regulatory Commission regulates the company's wholesale sales and transmission services in the same manner as those of APS.

APS and Edison understand that the principal goal of the sponsors of S. 1567 is to amend Section 206 of the Federal Power Act so as to provide the wholesale and transmission customers of public utilities with the ability to obtain refunds related to rate decreases within a specified period of time from the date after which a complaint is filed. The imposition of the refund effective date supposedly parallels the effective date of refunds relating to rate changes sought by the utility under Section 205 of the Act. The premise of the legislation sounds fair, but may not be equitable unless clarified. APS and Edison are concerned that the bill, as drafted, even with the modifications previously approved by the House of Representatives for the companion measure before that body, may unwittingly give the customers the opportunity to obtain a modification of existing rates, terms, and conditions of service under less onerous or different conditions than those confronting the utility company in similar circumstances. It is unclear whether the proposed legislation is to provide only for a refund effective date or is also intended to set the date on which a requested change in rates, terms, or conditions of service is to take effect. From a practical perspective, it may be that changing the refund effective date substantively results in giving earlier effect to a change yielding a refund under Section 206 anyway.

Specifically disturbing to APS and Edison is the failure of S. 1567 to address the applicability of the language amending Section 206 of the Federal Power Act to the burdens and duties embodied in what is known as the Sierra-Mobile doctrine. The doctrine arose from those instances where the contract at issue either did not give the public utility the unilateral right under Section 205 to seek a modification of the rates or conditions of the agreement or limited the procedures for such requests. APS and Edison are concerned that the proposed amendment of Section 206 rests on an assumption that the utility always has the right to request increases under Section 205. That assumption is in error. Certain contracts have been interpreted to be subject to change by a utility only under Section 206. This means that the requested change cannot be made effective until the case is concluded, most likely at the time of the compliance filing. Thus, no refund obligations arise under these contracts for the utility and conversely should not arise under the proposed amendment.

In 1956, the Supreme Court rendered two decisions interpreting the ability of electric utilities (under Sections 205 and 206 of the Federal Power Act) and natural gas pipeline companies (under Sections 4 and 5 of the Natural Gas Act) to seek changes to rates or other provisions of contracts or tariffs where the contracts or tariffs contain no language providing for a change. The two decisions are reported as FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956), and United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956). Because of almost identical language appearing in the provisions governing the procedures for changing rates of the Federal Power Act and the Natural Gas Act, rulings interpreting one of the statutes are generally applied to the other. This accounts for the term Sierra-Mobile being applied to rate changes under both statutes.

The doctrine basically embodies what the United States Court of Appeals for the District of Columbia Circuit has called a "refreshingly simple" rule: rate changes in conformity with a contract are valid; changes conflicting with the contract are invalid. Richmond Power and Light v. FPC, 481 F.2d 490, 493 (D.C. Cir.), cert. denied, 414 U.S. 1068 (1973). In reaching its decisions in Sierra and Mobile, the Supreme Court recognized that the relationships between the electric utility or the gas pipeline and their respective customers are initially established by private contract, 350 U.S. at 339, and that neither statute evinces any purpose to abrogate private contracts. The Court further acknowledged that, while the statutes do provide a method whereby the utility must notify the Commission of any proposed change in rates, the various rate change provisions of both acts only define and implement the power of the Commission to review rates initially set by the regulated entity. Drawing upon these premises, the Court reached the conclusion that, except as specifically limited by statute, the rate-making powers of electric utilities and gas pipelines were to be no different than they would possess in the absence of the Act. In other words, the utilities have the right either to establish on their own initiative, and change at will, the rates offered to the wholesale customers, or to fix by contract, and change only by mutual agreement, the rate agreed upon with a particular customer. Section 205 of the Federal Power Act only requires that, when the utility does change the rate, the Commission must be given proper notice. The statute does not invest the utility with the unilateral right to change the contract.

Since the issuance of the Sierra-Mobile decisions, an electric utility may only seek a rate increase to the extent that its contract with the customer so allows. If the contract has no rate change mechanism, then no change is permissible by the unilateral action of the utility under Sections 205 or 206, even if the Commission finds the current rate to be unjust and unreasonable. The impediment is equally applicable to the Commission when it acts on its own initiative under Section 206 of the Federal Power Act to modify the existing rate, terms, or conditions of service simply for being unjust and unreasonable. To overcome the impediment both the utility and the Commission must meet a greater burden of showing that the "public interest" requires that the contractual rate be modified. 350 U.S. at 355. The Court viewed this "public interest" burden as being distinct from the "unjust" or "unreasonable" standards. This heavier burden has proven so onerous that no utility has been able to mount a sufficient evidentiary record meeting the test as distinct from the "unjust" or "unreasonable" standards of Section 206.

Subsequent to the Sierra-Mobile decisions, which were concerned with contracts where rate change provisions were absent, there arose a line of cases which recognized that parties may enter into contracts which specify that rates may be changed in a manner different from that provided in Section 205 and not, at the same time, need to meet the strict "public interest" standard before implementing the change. Under this method, which was the subject of the decision in Electrical District No. 1 v. FERC, 774 F.2d 490 (D.C. Cir. 1985), the utility and its customer may agree that the changes will not become effective until the Commission issues a specific order under Section 206, such as an acceptance of a compliance filing. In these situations the utility need only prove that the existing rates are unjust and unreasonable. Kansas Cities

v. FERC, 723 F.2d 82, 87-88 (D.C. Cir. 1983); Papago Tribal Utility Authority v. FERC, 723 F.2d 950, 953 (D.C. Cir. 1983), cert. denied, 467 U.S. 1241 (1984). In these circumstances, the utility may not avail itself of the provisions of Section 205 which permit the implementation of the new rates after a suspension period. In effect, any relief approved by the Commission may become effective only after years of litigation, not on the date, or a few months thereafter, that the utility initially filed for the modification or the date upon which the Commission set the matter for hearing. In the presence of these restrictive contracts, the utility must wait until the Commission accepts the compliance filing before a justified rate increase or decrease may become effective. This rule holds whether the utility is seeking a rate increase or is proposing a rate reduction.

Although the Sierra-Mobile doctrine arose in the context of the utility seeking a modification of existing contractual terms, the restriction on unilateral rate changes has been acknowledged as applying equally to customers who seek to modify the contract where the contract has no rate change mechanism. See Papago Tribal Utility Authority v. FERC, 723 F.2d at 953-4. See also Philadelphia Electric Company, 15 FERC ¶61,264, at 61,101 (Jun.

17, 1981); Delmarva Power and Light Company, 12 FERC ¶61,002, at 61,003 (Jul. 2, 1980). If parity is the object of the proposed legislation, then the customers with contracts restricting changes to proceedings under Section 206 should be in no better position to obtain relief earlier or with a lesser burden of proof than the utility could realize under the same constraints.

Given that the Sierra-Mobile doctrine is the product of judicial interpretation, it is not surprising that it has not played a major role in the legislative consideration of the Regulatory Fairness Act, which seeks to amend Section 206 of the Federal Power Act. The language of S. 1567 provides a customer or the Commission with the opportunity to challenge an existing contract and to make any modification resulting in a refund effective retroactively from a date computed from the institution of a complaint proceeding. The proposed amendment also imposes on the Commission or the complainant the obligation to prove that the existing rate is unjust and unreasonable. The bill speaks nothing about compliance with rate change provisions of existing contracts or the burden of proof to be met where a contract does not have any rate change mechanism. APS and Edison are particularly concerned that the amendment, which purportedly is designed to give the wholesale customers rights similar to that available to utilities under Section 205, possibly carries an inference that the Commission and the customers may have greater rights and easier remedies than the utility has under the contract in dispute. The allowance of such an inference effectively abrogates the contract between the parties. Such a result can hardly be called equitable.

A second point of concern of both companies is the possibility that the language amending Section 206 grants the Commission, in addition to the authority to order retroactive refunds, the power to impose new remedies or methods of compensation. As with their position as to the Sierra-Mobile doctrine, APS and Edison believe that the new provision should be limited to empowering the Commission to grant a remedy only to the extent the remedy would have been appropriate under Section 205 of the Federal Power Act.

So as to limit future disputes over the scope of the new language and to maintain the parity between relief sought under either Section 205 or the amended Section 206, any explanation of the intent of the amendment should contain a declaration that the legislation is not intended (1) to disturb or abrogate any contractual obligations or to relieve any party to a contract of any burdens which inure to the party because of existing terms and conditions, or (2) to expand the remedial authority of the Commission other than to order refunds under Section 206. The insertion of following language in the conference report should accomplish that purpose:

> The Committee recognizes that judicial and administrative decisions have established a number of rules of law under the Federal Power Act setting forth the evidentiary showings under Section 206 of the Act which must be made by the Commission, the public utilities, their customers, or third parties to modify filed rate schedules or contracts between the utilities and their customers. This amendment to Section 206 does not change those rules of law or change the legal bases for the Commission to modify filed rate schedules or contracts under Section 206. Nor is this amendment intended to expand the Commission's authority as to the availability of remedies or compensation, other than the authority to order refunds under Section 206.

On behalf of Arizona Public Service Company and Southern California Edison Company, I wish to express the two companies' appreciation for the opportunity to present these comments and for the Committee's courtesy in considering them.

Coopers
&Lybrand

certified public accountants

One Post Office Square
Boston, Mass. 02109

telephone (617) 574-5000
TWX 710-321-0489
telex 6817018

in principal areas of the world

November 14, 1987

Mr. Edward Berlin
Swidler & Berlin
3000 K Street NW
Suite 300
Washington, D.C. 20007

Dear Mr. Berlin:

We have received and read the proposed legislation S1567 and H.R. 2858. In particular, we noted that the proposed legislation would require the Federal Energy Regulatory Commission (the "FERC") to establish a "refund effective date" whenever the Commission institutes a proceeding under Section 206 of the Federal Power Act (16 U.S.C. 824e).

As described in the proposed legislation, any decrease in allowed revenues, as ultimately determined by the FERC, would be effective from the "refund effective date". Therefore, revenues would be billed subject to refund from the "refund effective date" until new rates were put into effect.

Under current generally accepted auditing standards, in the event that a decision as to the amount of refund required for a fiscal year is not finalized by the date that the audited financial statements are released for that fiscal year, it is quite possible that the auditor's report will contain a qualification as to the ultimate realizability of reported revenues and the potential effect on net income. The resolution of such an uncertainty could also affect a utility's ability to comply with restrictions in its debt covenants or indentures, which would be noted in the auditor's qualification also. Such a qualification is quite possible for the following reason:

> The potential reduction in reported revenues could very easily be material to the net income of the fiscal year reported on. While materiality is a judgmental determination, generally any adjustment greater than 3 to 5 percent of net income is considered material, and it takes only a small change in revenues to have such an impact on net income. For example, a change in revenues of only 1 percent would usually have more than a 5 percent effect on net income for a utility which reported net income equal to 10 percent of revenues.

We hope that this information will be of assistance to you in understanding the potential implications of the refund provision in the proposed legislation. Needless to say, such a qualification in the auditor's report can have negative implications for a utility, including an effect on its stock price and its costs of borrowing. Please advise us if we can be of an further assistance.

Very truly yours,

Coopers & Lybrand

Coopers & Lybrand

TESTIMONY OF

Arkansas Public Service Commission

Robert Johnston, Chairman
Patricia S. Qualls, Commissioner
Julius Kearney, Commissioner

on

"The Regulatory Fairness Act of 1987"

Regulation of electric utility monopolies is designed to ensure that consumers receive the lowest possible cost for a vital service and to allow utility investors recovery of prudently-incurred costs as well as a reasonable return on that investment.

Regulators have taken varying approaches to requests for rate adjustments. Many states, including Arkansas, suspend the institution of any rate adjustment until the completion of a commission proceeding and issuance of a final order.

The Federal Energy Regulatory Commission takes a different tack. Under the Federal Power Act, requests for rate increases by public utilities under Section 205 of the Act are either accepted, rejected or set for hearing. Rate adjustment requests that are set for hearing are suspended for a period ranging from one day to five months. However, in contrast to most state action, rarely does the FERC complete its proceeding within the suspension period. Consequently, the company is allowed to begin collection of its requested rate, subject to refund, prior to a determination by the FERC of a just and reasonable rate.

In contrast, under Section 206 of the Federal Power Act, rate reduction proceedings initiated on the Commission's own motion or in response to a complaint filed by a wholesale customer, state commission or other party, can produce only prospective relief at the end of FERC's long, slow hearing and order process for setting just and reasonable rates. In fact, according to a recent decision by the 10th U.S. Circuit Court of Appeals, the lowered rate does not go into effect until the supplying company has made a compliance filing with the FERC--a step that usually is not completed until several months following FERC's issuance of a final order. Public Service Co. of New Mexico v. FERC, See Inside FERC, November 16, 1987, p. 8.

The Regulatory Fairness Act (RFA) seeks to equate the regulatory process employed for rate decrease requests with that used for rate increase requests. Under this legislation, an effective date is established at the time FERC sets the complaint or motion for hearing. If a rate reduction is ultimately ordered, the reduction would begin on the effective date prescribed, with the company refunding the overcollections paid during the pendency of the proceeding.

Despite the apparent fairness and equity of this legislation, the investor-owned utilities have sounded the alarm, predicting grave financial consequences if this legislation is enacted. Following is a review of these claims and what we consider to be a fair response to them.

According to the testimony of the investor-owned utilities, this legislation poses substantial financial uncertainty for the companies--which translates into higher risk, cost of capital, and ultimately higher electric rates.

Under the Federal Power Act, Congress empowered the FERC to determine and fix the "just and reasonable rate" for jurisdictional companies and to adjust rates where the existing rates are unjust, unreasonable, preferential or discriminatory. Congress, however, has provided no formula to determine what is a just and reasonable rate.

The just and reasonable rate standard was affirmed by the United States Supreme Court in the landmark Hope decision, Federal Power Commission, et al. v. Hope Natural Gas Co., 320 N.S. 591 (1944), as calling for a balancing of the interests of ratepayers and investors. A just and reasonable rate is reached when the rate falls within the "zone of reasonableness," with that zone bounded by exorbitant rates on the one hand and confiscatory rates on the other. Hence, the interests of investors are deemed to hold a position equal to that of consumers when regulators set a just and reasonable rate. The Court in Hope said:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock . . . . By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credits and to attract capital.

Hence, investors have come to expect that regulated utilities will be allowed to recover their prudently-incurred expenses and a reasonable return on their investment.

This legislation, however, does not contradict that standard. The just and reasonable rate doctrine is unaltered by the RFA. All that is changed is the date on which the rate reduction begins. It should be clear that this bill imposes no real risk, since the company will be ordered to refund only that which is above the just and reasonable rate. By definition, the investor is not denied what he is due and what regulation is obliged to provide: a just and reasonable rate. All that will be refunded to consumers under this legislation is undue revenue collected during the pendency of the proceeding.

The companies allege that the investments of shareholders and bondholders will become risky under this legislation because the revenue stream of the company is uncertain: previously collected revenue could be ordered returned to customers. In response, we point out that, in fact, the potential refunds do not create additional risk since the investor has never been guaranteed a specific revenue stream. Rather, the investor believes that the company will recover its prudent investments and investors will receive a reasonable rate of return. As stated in Federal Power Commission v. Natural Gas Pipeline Co., 315 N.S. 575 (1942), and reaffirmed in Hope, "regulation does not insure that the business shall produce net revenues."

Even if one accepts the utilities' argument that the investor will perceive additional risk, we submit that this risk is not different from that which exists in the current business environment. Companies face uncertainties from market forces (selecting a time for new-debt financing), environmental factors (low water years of hydroelectric production), engineering problems (unplanned outages), as well as regulatory and judicial action. Indeed, even without the proposed refund provisions of the Regulatory Fairness Act, a utility could allegedly be exposed to some amount of risk with a normal Section 206 complaint. The risk is that rates could be lowered. The refund provision of this legislation adds very little risk, if any, to that.

Under Section 205 of the Federal Power Act, rate increases are allowed to go into effect after a brief suspension period and subject to refund. The companies acknowledge this refund liability in their testimony, but attempt to distinguish it from the refunds contemplated under S. 1567 by asserting that the refund liability is bounded by the previously filed rate. In contrast, the companies suggest, the refund liability imposed by this legislation is both limitless and unquantifiable.

The companies are incorrect on both scores. The refund liability a company would face does have a limit: the just and reasonable rate set by FERC. FERC may not now, and could not under this legislation, fix an arbitrary rate or one which would be a violation of the tenets of utility regulation and constitutional law. The company can be ordered to refund no more than that which is above the actual and prudently-incurred costs, plus a reasonable rate of return. Further, the public interest test contained in the House-passed bill provides the Commission sufficient discretion to waive or reduce a refund if it is found to be adverse to the public interest.

It should also be pointed out that in the electric utility industry today, and for the next few years, the primary source of risk, from the investors' perspective, is that of abandoned plant (usually nuclear) and/or excess capacity. Any alleged "refund" risk is miniscule compared to that, and will have an immaterial impact on a utility's cost of capital.

Nor is the maximum refund liability unquantifiable. The company can use FERC's cost of service analysis to compute costs it will likely be allowed to recover. Many companies use cost-of-service formula rates in which rates are automatically adjusted to correspond to changes in most cost components. In addition, the company can use the Commission's benchmark to calculate the return on equity. Furthermore, the complainant specifies in the complaint the changes being sought, from which the company can begin a quantification of its potential liability. Finally, at the time commission staff and intervenors file testimony, a specific amount of relief is requested and a justification presented.

While the ultimate decision of setting a just and reasonable rate lies with the Commission itself, given the information available, any quantification of maximum refund liability by the company will be within close proximity to the final rate set.

Under current state and federal regulation, companies are already faced with the possibility of refunding previously collected revenue. For instance, both federal and most state regulation allow utilities to incorporate fuel adjustment clauses in their tariffs. Under these fuel adjustment clauses, rates are adjusted automatically to correspond to increases and decreases in the cost of fuel for the supplying utility. However, if a company incurs imprudent costs, or unfairly passes certain costs on to the customer, the company can be ordered to refund previously collected revenue. This has occurred in Arkansas on several occasions in recent years. In this refund scenario, at the time the proceeding was initiated no specific maximum dollar refund liability was set by the relevant regulatory body. Rather, the "floor" was the just and reasonable rate standard. Complaints instituted under S. 1567 would operate in the same fashion.

Despite the claims of the power companies, investors are aware that utilities are not risk free. Various forces affect the revenue earnings of a company. This legislation should not result in a perception among investors of increased risk since, as described, the commitment to fix a just and reasonable rate is left unchanged.

The Section 206 "refund" concern on the part of the utilities should be juxtaposed with the fact that refunds are expressly provided for when utilities seek increases under Section 205. If, indeed, the possibility of refunds with the Regulatory Fairness Act causes problems in the financial reporting of revenues, then that same problem exists with the current Section 205. Perhaps the utilities would argue for elimination of Section 205 refunds so as to make their financial reports pristine.

Mr. Jackson's claim on behalf of Middle South Utilities (MSU) that there is a meaningful difference between a Section 205 filing and a Section 206 filing does not ring true when one recognizes that under both types of filings there is a challenge to the continued effectiveness of a previously-approved rate.

There is another flaw in the utilities' case against 206 refunds. Elimination of the refund provision in the RFA would lead to an unlevel playing field for at least two reasons: (1) If both Sections 205 and 206 filings occur on an on-going basis so as to keep a utility earning its cost of capital on average, the failure to provide refunds under Section 206 means that a company will earn, in the long-run, in excess of its cost of capital. That is because the money that should have been refunded, under the RFA, represents excess earnings. However, under the current Section 205, there will be nothing to offset those excess earnings; (2) Even in a settled case, the bargaining position of the ratepayers' interest is diminished in the absence of a "refund" provision. The utility, in essence, has a powerful bargaining chip--the effective date of the change. Ratepayer representatives, on the other hand, may have the incentive to accept a higher rate of return because of the lag (in effective date) problem.

With regard to assertions that financial coverage ratios would be negatively impacted because portions of revenues would be considered refundable, the House-passed bill provides FERC sufficient discretion to consider that impact in ordering the refund. If, indeed, a company is over-earning significantly, the financial coverage ratios will not fall below any institutional "threshold level" during the refund period.

The companies have repeatedly suggested the need for a refund "floor"--or, more precisely, a revenue floor below which their refund obligation would not fall. In presenting their case, the companies note that in the case of Section 205 increases the refund can go no lower than the previously-filed rate. It should be noted, however, that the prospective just and reasonable rate may be set below the previously-filed rate.

To correct the perceived problem in the legislation the companies have offered two alternative approaches: FERC would either set a maximum refund level at the time the motion or complaint is set for hearing or disallow any refund that would bring the company's financial condition below a certain level.

Neither approach is sound. First, we note that while the Commission is a party to any proceeding, it is not the only party. The proceeding may have been initiated by one or more third parties on complaint, and numerous parties could have intervenor status. While FERC is cloaked with the responsibility of setting the just and reasonable rate, it is inappropriate to assign it the role of arbiter this early in the regulatory process. We note that in a Section 205 rate increase proceeding the Commission does not act so precipitously: the rate which is requested by the company goes into effect, following suspension, without modification by the FERC. Such a floor in a Section 206 case would prevent the customer from receiving equal treatment.

The second suggested structure for a refund floor--tying refunds to the financial health of a company--is even more disturbing. An automatic exemption from refund obligations for financially shaky companies contradicts the most basic tenets of monopoly regulation. First of all, regulation is not required to insulate a company from market forces. As the Supreme Court held in Market Street Railway Co. v. Railway Commission of State of California, 324 N.S. 548 (1945), handed down only one year after the Hope decision:

> The due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.

Yet that is precisely what this exemption would provide. If a company's economic woes are attributable to bad management decisions, market forces, or the action of other regulators, the FERC would be required to shelter the company despite the absence of a nexus between the company's economic condition and the action of the FERC.

This proposed exemption would not seek merely to ensure FERC consideration of the economic condition of the company--the position advanced in the recent D.C. Circuit decision in Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168 (D.C. Cir. 1987)--but would take this argument one step farther by making the financial health of a company the sole determinant of whether refunds of excessive revenues should be ordered. Such action would effectively foreclose FERC's ability to exercise its statutory responsibility of balancing the respective interests of ratepayers and investors. In short, it would guarantee profits to the most financially-troubled, poorly-managed companies.

Further, such an exemption would shift the burden of proof onto the Commission. That is unfair to ratepayers. The exemption would, in essence, require FERC to prove a negative --that the asserted financial distress would not occur--before any refund could be ordered. This provides an additional and unnecessary hurdle that could undermine the expeditious regulatory procedure that this legislation seeks to provide.

The financial test outlined by Middle South Utilities is not the only or the most appropriate test of financial health of a company. The MSU amendment cites the ability of the company to raise capital, but under what terms? Short-term or long-term debt? Preferred or common stock? A company can be in poor financial health and yet be charging excessive rates. For example, consider the recent Section 206 proceeding brought against MSU's System Energy Resources, Inc. (SERI) by the Louisiana Public Service Commission, in which the APSC also participated as a complainant. Despite the difficult conditions that everyone recognizes MSU currently faces, the company agreed in this proceeding to lower its return on equity from 16 percent to 14 percent and, further, that the lowered return would remain unchanged until January 1, 1990. Despite the substantial risks the company currently faces, by accepting lower rates in a settlement, SERI acknowledged that it can accept a return on equity only slightly higher than the FERC benchmark and freeze that return on equity for three years.

There is no reason why the ratepayers of the affected MSU operating companies should not have received the full benefit of this rate reduction and recovered the overcharges (which the APSC staff has calculated as approximately $1 million per month for Arkansas ratepayers) paid during the pendency of the proceeding. The implication of the proposed MSU amendment is that a company in poor financial health should be allowed to charge rates other than that which are just and reasonable.

Even in the case of SERI, a case handled with unusual speed by FERC, ten months elapsed (September 1986 to July 1987) before a compliance filing was made and ratepayers obtained the benefits of the lower rate of return on equity.

In essence, SERI was allowed to overearn for almost a year. Under the RFA ratepayers would have equitably received the benefits of at least three months worth of a rate-of-return reduction, a reduction that even SERI agreed was appropriate.

It is clear that neither of these "floor" mechanisms is appropriate or sound. More importantly, neither is needed. The first is designed to give the company a fixed quantification of its maximum liability. As discussed above, this is unnecessary; the companies are able to predict with a high degree of accuracy their maximum liability. Again, we stress that no such "floor" exists in current state or federal refund proceedings involving tax allowance or fuel adjustment clauses.

Nor is a "financial floor" needed. The House-passed bill provides FERC sufficient discretion to consider the financial condition of the company prior to ordering a refund. The House provision is a rebuttable presumption, under which it is assumed that the refund should be ordered unless the company can demonstrate that such refund would be adverse to the public interest.

As regulators, we strongly endorse this added discretion and urge its adoption in the Senate bill. However, while the House provision grants the FERC needed discretion, the financial floor provision suggested by Middle South Utilities would take it away, thus tying the hands of the FERC and providing an automatic exemption.

In summation, the "floor" argument is largely a red herring. The companies can, and regularly do, predict a refund obligation--they do this every time they request a just and reasonable rate, since the refund cannot go below the true floor contained in this legislation: the just and reasonable rate standard. Second, for those cases where a refund is not appropriate, given the financial health of the company, the Sierra-Mobile public interest test provides sufficient discretion to accommodate the concerns of the industry.

We strongly urge the committee to reject the inclusion of an artificial floor in this legislation.

The Middle South testimony also calls for an exemption from this bill for "interconnection, power pooling, intra-system, joint electric facility ownership, or coordination agreement(s) among affiliated or non-affiliated public utilities." This exemption was endorsed by the other industry witnesses.

It was suggested that this amendment is needed because these arrangements are highly complicated and failure to provide an exemption would discourage the efficiency that these agreements provide. It is correct that some of these agreements are complex. However, most of the "complex" situations would not likely involve refunds. For instance, an economy transaction schedule in which the buyer and seller split the savings is not a situation in which this refund provision would likely come into play. Unfortunately, there are many other situations in which refunds would be appropriate that would fall within this broad exemption. Firm power sales, with explicit terms and conditions, are no more complex than requirements sales, and no less deserving of the full and fair relief contemplated by this legislation.

The true intent of this proposed amendment is to deny the benefits of this legislation to a large percentage of electric ratepayers that are served by investor-owned utilities and relegate them to second-class citizenship. In his testimony, Mr. Mundy of EEI suggested that this legislation may be appropriate for captive requirements customers, such as public power systems and rural electric cooperatives, but should not apply to "wholesale agreements between major investor-owned utilities." We strongly disagree.

Adoption of this legislation would be the most recent swipe at state utility regulatory commissions. Under the Narragansett doctrine, once FERC fixes a rate for the sale of power at wholesale in interstate commerce, a state utility commission may not make its own determination that those FERC-approved rates are unreasonable. In essence, if a state commission believes that the bulk power costs paid by a state jurisdictional company are too high and that the corresponding retail rates should be reduced, the means to accomplish this result is for the state commission to initiate a Section 206 proceeding at FERC. Under the proposed amendment, states following this already inadequate procedure would be precluded from receiving the benefits of this legislation.

While there may be situations where a refund involving such an agreement between affiliated or non-affiliated investor-owned utilities may not be appropriate, the "public interest" test prescribed in the House-passed bill provides sufficient latitude and discretion to FERC to resolve any problems that may arise.

We urge the committee to reject this amendment. Its enactment would work against the interests of the majority of ratepayers and further erode the jurisdiction of state regulatory commissions.

While there are other changes suggested by the companies with which we are disturbed, we have limited our statement to the two amendments discussed above. We urge the Committee to reject these amendments and report S. 1567 with the House-passed "public interest" modification discussed above.

STATEMENT OF RAYMOND J. O'CONNOR
CITIBANK, N.A.
on behalf of
NEW ENGLAND POWER COMPANY
on The Regulatory Fairness Act (S. 1567)
Before the Senate Committee on Energy and Natural Resources

Mr. Chairman and Members of the Committee, my name is Raymond J. O'Connor. I am Vice President of Citibank, N A., and immediate past Chairman, Federal Energy Regulatory Commission (F.E.R.C.). Citibank is the largest financial services concern in the United States and one of the largest providers of financial services to the electric utility industry.

I appreciate this opportunity to comment on S. 1567, "The Regulatory Fairness Act" and its impacts on the FERC and utilities subject to its jurisdiction. I have reviewed this proposed legislation and have concluded that the current regulatory framework, namely, Section 206 of the Federal Power Act, should be maintained.

Section 206 relief is prospective only because the FERC had previously found a utility's current rates to be "just and reasonable" under Section 205 of the Federal Power Act. It is in the public interest to preserve the integrity of commission orders that constitute the basis of investment decisions. The commission has frequently recognized that when financial commitments are made on the basis of its orders, special attention not to disturb the basis of the commitments is required.

Commission orders set rates for the future. Citibank and all other lenders and investors base their commitments upon projections of future revenues and income of the utility company. If utilities' revenue streams were subject to recapture, as proposed in S. 1567, *after* they have been found to be "just and reasonable" by a commission order, such order could not be relied upon by lenders and investors since reasonable projections of future revenues, cash flow and debt service coverage would not be possible.

In addition, enactment of S. 1567 would cause substantial uncertainty as to a utility company's ability to meet interest coverage tests in bond indentures and, thus, its ability to issue long-term debt to refinance bank loans. S. 1567 would likewise adversely affect a utility's charter coverage provisions relating to preferred stock issuance by utility companies.

In conclusion, I would urge this Congress not to amend Section 206 of the Federal Power Act. The existing provision is wisely conceived, makes sense, and maintains the integrity of the commission's orders on the basis of which bank loan commitments are made to jurisdictional public utilities.

Statement of James E. O'Neil,
Attorney General of the State of Rhode Island,
before the
Senate Committee on Energy & Natural Resources
concerning
The Regulatory Fairness Act, S. 1567

January 6, 1980

Mr. Chairman and Members of the Committee, I am grateful for the opportunity to express to you my support of the Regulatory Fairness Act passed by the House of Representatives. The Rhode Island Department of Attorney General represents the interests of Rhode Island's consumers of electricity in proceedings before the Federal Energy Regulatory Commission, and we are vitally interested in the proposal now before you.

At the outset I would like to point out that we are not here requesting any adjustment to the Federal Energy Regulatory Commission's statutory obligation under the Federal Power Act to establish "just and reasonable" electric utility rates. We are not suggesting any change in any of the regulatory policies of the Commission that guide it in determining "just and reasonable" rates, nor are we suggesting any limitation on the full access enjoyed by utilities (and paid for by their customers) to the adversary regulatory process. We suggest only that when, after its review and deliberations, the Federal Energy Regulatory Commission has determined what the "just and reasonable" rate should be, consumers get the same procedural schedule as utilities for implementation of the rate. We have had first hand experience of the unfortunate and unfair discrepancy that now exists between the effective date schedules of utility rate increases and utility rate decreases brought about by customer rate challenges. This disparity results in utilities obtaining revenues above the "just and reasonable" rate for a given period.

As you know, utility rate increases go into effect after a sixty-day notice period from the filing of the increase--unless the Federal Energy Regulatory Commission ("FERC") determines that the rate increase may be unjust, unreasonable and substantially excessive, in which case it goes into effect five months later. West Texas Utilities Company, 18 FERC ¶ 61,189 (1982).

Regulatory proceedings initiated by customer complaints, on the other hand, do not have any effect until the final decision of the Federal Energy Regulatory Commission, and then go into effect only prospectively. FERC deliberations can take years: In Rhode Island we have just put into effect a 1987 FERC decision in a case filed in 1981 and 1982. Montaup Electric Company, FERC Docket Nos. ER81-749-003 and ER82-325-002 (Phase II).

On this uneven playing field, the adversary regulatory process is unbalanced in favor of utility interests. For example, the New England Power Company provides wholesale electric service to its Rhode Island affiliate, Narragansett Electric, which serves over 70% of Rhode Island's electric utility customers. New England Power makes annual rate filings with FERC, and we are now challenging its request for 1987 rates providing a revenue increase of $11 million per year.

The $11 million rate increase would permit New England Power to pay nearly $200 million to its stockholders, a return on their equity of 14.75% per year. The FERC benchmark rate of return on common equity established for the relevant time period was 12.75%. Notice of Update to Benchmark Rate of Return on Common Equity for Public Utilities, July 30, 1986, FERC Docket No. RM85-19-000. A reduction of 2% in the rate of return would save New England Power's customers about $25 million per year, eliminating the $11 million increase and causing a $14 million annual rate reduction. Unfortunately, this is a rate reduction NEP's customers will never see.

The question faced by the Federal Energy Regulatory Commission is: what is the "just and reasonable" rate for the period addressed by this filing? If the Federal Energy Regulatory Commission determines that 14.75% is a "just and reasonable" rate of return for NEP's stockholders for 1987, NEP will collect the full rate increase as of April 1, 1987. (For purposes of illustration, we are assuming every other element of NEP's filing stands up to regulatory scrutiny.) However, if the FERC eventually determines that 12.75% is the "just and reasonable" rate of return for 1987, and that the $11 million increase in the filed rate was $25 million too high, the decrease of $14 million would only be effective prospectively. The best that customers can hope for is a refund of the revenues attributable to the $11 million increase, which were collected subject to refund. F.P.C. v. Sunray DX Oil Company, 391 U.S. 9 (1968).

The purely prospective relief resulting from a FERC decision in favor of customers would not reach back to 1987, and NEP's stockholders would pocket the $14 million in revenues found to be unjustified, notwithstanding the regulatory determination that this $14 million was not "just and reasonable" for the period in question. The dichotomy is simple: if we win, we don't get the "just and reasonable" rate we won; if the utility wins, it does.

My office objected to the rate of return sought by New England Power when its filing was made, but the electric customers we represent had no real remedy. The process I have just described foreclosed that. The Regulatory Fairness Act would provide them with a remedy: Rhode Island's objection could take the form of a complaint under Section 206 of the Federal Power Act, and we could have the same effective date if we win that the utility obtains if it wins. This is nothing but parity, and no more than fair.

The problem is a continuing one. New England Power's new rates for 1988 are proposed to go into effect January 1, 1988. They implement the federal Tax Reform Act to provide a $21 million reduction. The company has again sought a 14.75% return on equity. Again, we believe this element of the rates is about

$25 million too high. This time, since the net effect of the initial filing is a decrease and there is no increase to refund, all relief we might win in this proceeding will be purely prospective. NEP's stockholders will pocket the full $25 million for the year even if the eventual decision of the FERC is that the "just and reasonable" rate for the period is substantially lower. When NEP files a new rate for 1989, "locking in" its 1988 rate, purely prospective relief will be no relief at all.

The practical effect of the present policy is to give New England Power a $25 million "card" to play at the negotiating table, and to leave my lawyers in a negotiating position where their settlement options are of only two types; unrealistic, or unreasonable.

Unmuddied of all the specialized jargon and given the native complexity of regulating huge corporations, this committee is faced with a simple problem of equality and fairness. I hope I have been able to show you that your decision can and should be a simple one, and that it will have a real, direct and practical effect on the economic welfare of hundreds of thousands of Rhode Islanders and millions of your own constituents. In Rhode Island the effects are particularly severe because federal jurisdiction is particularly extensive, but the dilemma of consumer advocates is the same wherever the FERC has jurisdiction. In short, we are treated differently than our utility adversaries, and the unfair disparity costs my constituents millions of dollars in utility bills above the amount determined by federal regulators to be "just and reasonable".

On behalf of the citizens of Rhode Island, I thank you for your courteous attention to my views, and urge your support for the Regulatory Fairness Act as passed by the House.

Office of the
Consumers' Counsel
137 East State Street
Columbus, Ohio 43215

December 16, 1987

The Honorable J. Bennett Johnston
Chairman, Senate Energy and Natural
  Resources Committee
SD-364 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Johnston,

I am writing in support of the Regulatory Fairness Act of 1987. As Consumers' Counsel for the State of Ohio, my agency represents 3.5 million households across Ohio.

My clients, the residential consumers of Ohio will benefit if the Regulatory Fairness Act of 1987 is passed into law. It is for that reason that this agency's governing board adopted a resolution supporting the bill earlier this year. A copy of their resolution and my own statement is attached for the record. Described therein are the many reasons why we believe the bill should pass and rebuttals to investor-owned utility testimony in opposition to the legislation.

I urge you to carefully consider our position and favorably report the Regulatory Fairness Act of 1987.

Very truly yours,

William A. Spratley

WILLIAM A. SPRATLEY
CONSUMERS' COUNSEL

WAS/MJS/pt

STATEMENT OF WILLIAM A. SPRATLEY
Ohio Consumers' Counsel
on the Regulatory Fairness Act of 1987

The Ohio Consumers' Counsel is a state agency established by statute to represent residential public utility consumers before state and federal agencies that affect public utility regulation and policy. The Ohio Consumers' Counsel has appeared many times before FERC.

This agency's nine-member, bi-partisan Governing Board which establishes policies for the Consumers' Counsel passed a resolution favoring passage of the Regulatory Fairness Act of 1987 on September 23, 1987. A copy of same is attached.

Action by the Consumers' Counsel Governing Board was prompted by an existing imbalance in the regulation of wholesale electric rates. While Section 205 of the Federal Power Act allows FERC jurisdictional utilities to collect higher rates after a suspension period lasting no longer than five months, subject to refund when FERC proceedings have concluded, no such immediate adjustment is permitted for a rate decrease action. Thus, the Federal Power Act operates to protect wholesale suppliers when costs are increasing but fails to protect wholesale customers and ultimately retail consumers during periods of falling costs. The Regulatory Fairness Act of 1987 corrects this inequity.

Some investor-owned utilities have argued that the Regulatory Fairness Act of 1987 would place them in financial peril from unwarranted rate reduction complaints. They have suggested that uncertainty of potential refund timing and dollar amounts will lead to qualified financial reports. However, amendments adopted by the House Energy and Commerce Committee and passed by the House on October 27, 1987 give the FERC authority not to order refunds if it determines that such refunds would adversely affect the public interest. Also, the amended bill makes it clear that the FERC is to establish the refund effective date at the time it institutes a Section 206 proceeding. The amended bill also provides that any Section 206 complaint shall state plainly the change or changes to be made in the existing rate, charge, classification, rule, regulation, practice or contract, and the reason for any proposed modifications. Inherent in this provision is an indication of the potential refund level. Contentions that the Regulatory Fairness Act of 1987 will place utilities at financial risk are not well founded. Under Section 205, rate increases are in effect subject to refund upon final Commission decision. The refund levels there are also unknown but have an ascertainable limit. The same would be true for Section 206 under the Act.

Certain exemptions to the Act have also been proposed including agreements involving interconnections, power pooling, intra-system, joint electric facility ownership or coordinating agreements. To exempt these entities from refunds would be inappropriate in that they are subject to FERC jurisdiction and the just and reasonable standard. The financial impact of these arrangements on the consumers this office represents is very great, particularly with respect to interconnection agreements. An exemption would preclude affected consumers from the benefits which will flow from the Regulatory Fairness Act.

Investor-owned utilities have suggested that the FERC will be inundated with insubstantial complaints if this bill becomes law. I would point out however that although tax rates have been reduced and the cost of capital has decreased, relatively few complaints are pending at FERC. Although the FERC has called upon electric utilities to make voluntary reductions in rates as a result of the lowered corporate tax rate, many utilities have not complied. Even where reductions due to tax rates have occurred, similar action has not been taken to reflect lower capital costs and fuel prices. For those complaints that are pending, customers will have to wait until completion thereof or the conclusion of the investigation initiated by FERC in its Notice of Proposed Rulemaking in Docket No. RM87 1 00. Because of the length of time such proceedings take, wholesale sellers have little incentive to voluntarily reduce rates when their costs are declining. Voluntary rate reductions, if undertaken, are another means by which wholesale sellers can control their financial situation and avoid the alleged uncertainties associated with the proposed bill. In fact, passage of the Regulatory Fairness Act of 1987 will encourage utilities to voluntarily reduce rates to reflect declining costs. Under present law, voluntary reductions are few, and far between.

Residential public utility consumer utility rates are increasingly coming under FERC jurisdiction. Some utilities have corporate structures that result in wholesale power purchases from affiliates. Others have attempted to circumvent state regulation by spinning off their generating facilities into separate subsidiaries and then contracting to purchase power from those subsidiaries at a FERC set rate. The lack of the availability of refunds in rate decrease proceedings is one factor which apparently makes FERC a more favorable regulatory forum. Enactment of the Regulatory Fairness Act of 1987 would remove this distinction and ensure that consumers have an opportunity to share the benefits when a utility's costs are decreasing.

Other beneficiaries of the Regulatory Fairness Act of 1987 are customers of public power systems, and customers of rural electric cooperatives. These consumers and those of investor-owned utilities must respond to periods of inflation and increased taxes by paying higher rates, by law, after five months. These same consumers should also enjoy reduced rates when appropriate, without present regulatory lag.

For the reasons enumerated herein, I urge the Senate Committee on Energy and Natural Resources to act favorably on the Regulatory Fairness Act of 1987, as amended by the House Energy and Commerce Committee and passed by the U.S. House of Representatives earlier this year.

Bd. R. 87-25

RESOLUTION
OF
THE CONSUMERS' COUNSEL GOVERNING BOARD
STATE OF OHIO

Urging Congress to pass H.R. 2858 /S. 1567,
the "Regulatory Fairness Act," a bill that would
provide for refunds pursuant to rate decreases
under the Federal Power Act

WHEREAS, an increasing portion of electricity sales are regulated by the Federal Energy Regulatory Commission (FERC);

WHEREAS, Section 205 of the Federal Power Act allows FERC-jurisdictional utilities to collect increased wholesale electric rates during the time of review of those rates, after a maximum five month suspension period;

WHEREAS, the rate increases continue from the five month waiting period forward, subject to a refund upon completion of FERC review;

WHEREAS, Section 206 of the Act, governing rate decrease requests initiated by wholesale customers, state regulators, other affected parties, or the FERC itself, provides only prospective rate relief after the completion of FERC proceedings, which can last as long as two to three years;

WHEREAS, this regulatory asymmetry protects wholesale suppliers during times of rising costs, but fails to protect wholesale customers and ultimate retail customers during times of declining cost;

WHEREAS, legislation H.R. 2858/S. 1567, the "Regulatory Fairness Act of 1987," has been introduced in the U.S. Congress to amend Section 206 of the Federal Power Act to establish equity by providing retroactive, back to an agreed upon date, refunds for Section 206 proceedings;

WHEREAS, this regulatory process affects wholesale rates, and transmission costs paid for by residential utility consumers, and FERC procedures are commonly followed by state utility regulators;

WHEREAS, the Office of the Consumers'Counsel views this legislation as a first step toward elimination of any rates being placed under bond at FERC; and,

THEREFORE BE IT RESOLVED THAT the Office of the Consumers' Counsel Governing Board supports the passage of H.R. 2858/S. 1567, the "Regulatory Fairness Act of 1987" which, if passed, will create a regulatory process that is more fair and equitable to utility consumers.